Statement by

Mr. Angel Gurría
Secretary-General
and
Mr. Eckhard Deutscher, Chairman,
Development Assistance Committee (DAC)

Organisation for Economic Co-operation & Development
ODA Trends and Development Issues: Probability of Achieving Targets Fades

1. We are falling short

2. A more complex scenario: new challenges and offsetting factors
   - Higher food and energy prices
   - The deadlock of Doha: postponing free-trade is postponing development
   - Climate change: a development issue

3. Other key challenges: fragile states and pro-poor growth
   - The challenge of fragile situations and post-conflict States
   - Empowering the poorest: fostering pro-poor growth

4. To meet development targets we need more predictable aid and other sources of finance
   - Increasing predictability of aid: essential to effective budgeting
   - Other sources of finance

5. We also need to improve Aid effectiveness
   - AAA – The Accra Agenda for Action
   - Aid untying
   - Aid architecture issues
   - Effective aid management: 12 lessons from OECD DAC peer reviews

6. Partnerships for development
   - Achieving the MDGs
   - OECD-World Bank cooperation
ODA Trends and Development Issues: Probability of Achieving Targets Fades

1. We are falling short

Preliminary data on aid in 2007 are disappointing. On the whole, donors are not on track to meet their stated commitments to scale up aid (see Figure 1 below) and need to achieve unprecedented increases to meet the targets they have set.

After falling in 2006, total net Official Development Assistance (ODA) fell a further 8.4% in real terms in 2007; reaching USD 103.7 billion. Debt relief had been unusually high in 2005 and 2006 (see Press Release, Annex A, Table A.2) because of exceptional levels of relief for Iraq and Nigeria. Excluding debt relief from the figures, net ODA actually increased by 2%. [Note: Table A.2 only gives data for 2006 & 2007].

Rises so far are not sufficient to meet the ambitious aid targets set for 2010. At the 2005 G8 summit at Gleneagles, donors made a series of individual pledges that, combined with the known commitments of other countries, would have lifted aid from USD 80 billion in 2004 to USD 130 billion in 2010, at constant prices – an increase of more than 60% over six years.¹ The preliminary data show that half way through those six years, total aid has risen by only 15%, well short of the rate required to achieve the increase envisaged at Gleneagles. A few donors have since scaled back their targets somewhat, but Figure 1 shows that they remain very challenging.

Figure 1: OECD-DAC members’ net ODA 1990-2007 and DAC Secretariat simulation to 2010

1 The United States made no overall ODA volume commitment at Gleneagles, but stated that it “proposes to double aid to Sub-Saharan Africa between 2004 and 2010”, had “the aim of providing up to $5 billion a year” through the Millennium Challenge Account, and had launched a “$15 billion Emergency Plan for AIDS Relief”, and other initiatives. All other G7 members at Gleneagles made or reiterated commitments to increase their total ODA volume, all EU members have targets for both 2010 and 2015, and all other DAC donors have targets or projections for total ODA volume.
There are some bright spots in the overall picture. Some OECD countries—Spain, Australia, Norway and Germany—are making encouraging progress in scaling up their core development programmes. Aid to sub-Saharan Africa is increasing at a faster rate than total aid, in line with the special emphasis on aid to this region at Gleneagles (though still not fast enough to meet the Gleneagles projection to double aid to Africa by 2010). The UNITAID scheme to raise aid funds from airline ticket taxes, as well as the IFFIm initiative to fund vaccinations, are both adding to resources for global health. New donors are also contributing an increasing share of aid, driven by an unprecedented co-operation engagement of China and India in Africa.

But fiscal stringency in other donor countries is hampering efforts to scale up aid. In 2007, Japan’s net ODA fell to 0.17% of its national income, the lowest level since it joined the OECD in 1964. France’s ODA, at 0.39% of its GNI, was more than 20% below its pledge of 0.5% made at Gleneagles. And three other DAC-EU members (Greece, Italy, and Portugal) gave less than 0.2% of GNI in aid, far below the EU targets of 0.33% for 2006 and 0.51% in 2010.

The challenge of scaling up aid flows is now greater, considering the current difficult circumstances that we face in the international economy. But the challenges noted below, mean that the requirements – and opportunities – for effective use of scaled up aid are even greater than foreseen in 2005. Donors’ credibility on aid volume pledges will be on the line this year as we prepare for the Doha Financing for Development review conference in November.

2. A more complex scenario: new challenges and offsetting factors

We are now facing a much more complex international economic panorama. And this is having an impact on our development effort.

The prolonged financial market turbulence and the economic deceleration in most OECD countries are constraining the budgetary capacity of their development strategies. At the same time, the global financial crisis is limiting the maneuverability of Central Banks to manage inflationary pressures from mounting food and energy prices; two factors that are already offsetting the positive impact of development aid. Moreover, the deadlock of the Doha Development Agenda and the multidimensional implications of climate change are offsetting many of the potential benefits of our development effort.

Higher food and energy prices

What impacts on poverty and hunger can we expect from the present spike in food prices? There has been a clear reversal in the long-term trend in the reduction of real food prices and the present spike has caught most forecasters by surprise. There are multiple explanations for this. Supply factors (e.g. lower production and yield shortfalls linked to weather conditions, lower stocks, and oil price-related factors) are important; particularly in explaining that part of the price increase that is expected to be very short term in nature. But demand factors, too, play an important role, particularly in relation to longer-term expectations of prices. In particular, high demand for biofuels produced from agricultural commodity feed stocks and growth in large emerging countries, such as China and India, are important. Expectations are that agricultural commodity prices will decline from their current peak, but will remain considerably higher over the next decade compared to the previous one. The impact of high food prices on developing countries depends on the interplay of various factors. Commercial producers will benefit directly from higher prices, as will in many cases the people they employ. For some farm households, such as subsistence-scale farms, the impact will be mitigated as they are not connected to either domestic or international markets. But for the urban poor and the major food-importing developing countries, the
impacts will be strongly negative and an even higher share of their limited income will be required for food. This is already producing social unrest in several African and Asian countries.

Regarding energy prices, we may see prices as high as USD 150 a barrel by 2030, if producers do not bring a lot more oil onto the market. Even if they do, and present signals are not that positive, building the extra capacity will take some time. Over the last three years, the rising costs of oil have been wiping out the benefits developing countries expected from higher aid and higher debt relief. For example, an IEA survey of 13 non-oil producing African countries found that the increase in the cost of oil since 2004 represented more than total ODA (including debt relief) to these countries and could easily dampen their otherwise good growth outlook. Obviously, the impacts on developing countries will also depend on their different situations. Present and potential producers will benefit as new energy sources become more economically viable, stimulating production and the rate of economic growth. However, the impact of that on poverty reduction will depend very much on whether the growth stimulus remains largely in the extractive sector (often the case) or whether there are strong mechanisms to transfer the initial growth stimulus to the activities and areas in which the poor are economically active, which has proven to be quite difficult in many developing countries.

For importing countries and consumers, the outlook is clearly worrying. Higher energy prices will add to the energy deficit already faced by many developing countries and considerably dampen growth prospects. It will also be much harder for energy providers and government regulators to balance the need for decent returns on investments with user prices that are affordable to consumers. Transport costs, too, will rise, adding a further impediment to growth and the ability of poor people to participate in the growth process. Food prices will also be under pressure. To the extent that governments resort to energy subsidies to mitigate the effects of higher energy prices to consumers, this could put upward pressure on inflation and/or have serious opportunity costs in respect of areas (e.g. rural communities) and activities (e.g. health, education) that receive smaller government transfers.

In 2000, the African continent enjoyed over 5% GDP growth for the fourth consecutive year. The economic outlook remains positive, thanks to sustained demand, high commodity prices, rising ODA and FDI, and improved macroeconomic management. Growth will accelerate for net oil exporters and weaken slightly for oil importers, continuing the trends projected in the OECD/AFDB African Economic Outlook 2007. This positive outlook is nevertheless vulnerable to the more challenging environment the continent is facing, due to the uncertainties linked to the recent global slowdown, the rising prices for oil and food, the energy crises in South Africa -the engine of African growth- and signs of social unrest. After several years of steady gains in political and social stability, the African Economic Outlook index for political troubles and hardening showed reversals in 2007. The rising cost of living -especially for food and fuel-fanned dissatisfaction among populations, as manifest in demonstrations in Senegal, Zambia and, more recently, in Burkina Faso and Cameroon. However, social instability risks are expected to remain limited if governments succeed in absorbing price shocks and if they succeed in developing a constructive dialogue with different components of society.

The deadlock of Doha: postponing free-trade is postponing development

The world economy is also falling short of its potential due to policies that impede trade. Yet we have within our reach the possibility to address an important part of this gap by concluding the WTO’s Doha Development Agenda trade negotiations over the next few weeks. We know a lot about the potential for freer trade to deliver tangible economic benefits to both developed and developing countries. Almost seven years into the WTO negotiations legions of analysts, both inside and outside the OECD, have demonstrated that multilateral trade liberalisation offers the prospect of globally inclusive economic benefits that go well beyond the scope of any regional trade accord.
Now is the time to make the final push, to harvest the considerable opportunities for liberalising trade that are within reach. Today, with historically high prices prevailing for many agricultural commodities, we have a unique opportunity to cut trade-distorting farm support, to open agricultural markets and to free up the productive capacity of the sector in developed and in developing countries. The trade negotiations also cover the far larger economic sectors of non-agricultural goods and services, as well as a variety of other trade-related issues. The broad scope of the potential package means both very large and widespread economic gains and, given current global economic conditions, this would be a particularly welcome boost. Finally, a positive conclusion to the Doha Development Agenda would represent an endorsement of the rules-based multilateral trading system, continued international engagement on trade and development issues, and an approach to global governance based on mutually agreed rules and concerted action, rather than conflict. We cannot let this opportunity pass us by.

**Climate change: a development issue**

The effects of climate change are particularly strong in the poorest countries; paradoxically, in those countries that have the smallest carbon footprint. These effects will in fact become grow progressively in the years and decades beyond the 2015, the target date for the achievement of the MDGs. Activities oriented towards reducing poverty, improving nutrition and education and promoting sustainable livelihood opportunities, in the context of strengthened environmental management, would significantly help reduce vulnerability to many climate change impacts. A healthier, better educated population with improved access to resources is likely to be better equipped to cope with climate change.

There is a need to place climate change and its impacts into the mainstream of economic policies, development projects, and international aid efforts. This was recognised in a key publication, *Poverty and Climate Change*, prepared jointly by ten multilateral and bilateral agencies in 2003. Subsequently, in 2006, development and environment ministers from OECD countries endorsed the *Declaration on Integrating Climate Change Adaptation into Development Co-operation*, in which they called for “meaningful co-ordination and sharing of good practices on integrating climate change adaptation in development co-operation” (OECD 2006).

In response to that Declaration, the OECD’s DAC and the Environment Policy Committee are working together to develop policy guidance for donors on how better to integrate climate change adaptation into development planning and assistance. This work involves close collaboration with many multilateral partners, notably the World Bank. Key objectives are promoting understanding of climate change and its impacts; identifying and using appropriate entry points for integrating adaptation to climate variability and climate change into development co-operation activities; and assisting developing country partners in their efforts to reduce their vulnerability to climate variability and climate change. We are pleased to note that the Bank finds the draft Guidance useful and relevant and look forward to continue this collaboration.

In line with the OECD’s DAC mandate to provide advice to its own members, the guidance is formally targeted at development co-operation policy makers and practitioners. Harmonisation of multilateral and bilateral donor practices in the area of climate change is a key objective. The main perspective, however, is that of partners’ own institutions, systems and processes. We therefore anticipate that the contents of the Guidance will be of direct interest and relevance to policy makers and practitioners in developing countries and their civil society partners.

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2 Data on aid targeting the objectives of the UN Framework Convention on Climate Change have been collected in DAC statistics since 2000. Two-thirds of DAC members have provided the requested data in recent years. The data indicate climate-change-related aid to be about USD 3 billion per year. This figure relates to climate change mitigation only. No data are currently available on ODA spending on adaptation.
Promoting understanding and providing appropriate tools and guidance are essential. But the costs of adaptation must also be a priority concern. Even at the lower range of current estimates, these costs will be significant. Clearly, development budgets offer the potential for only a small part of the financing required. The OECD therefore welcomes the Bank’s initiative to consider the new portfolio of Climate Investment Funds. We are pleased to participate in the meetings to consider these funds and to ensure that the results are factored into the DAC High Level Meeting in May, when development co-operation ministers and heads of agencies will pursue discussions on the role of ODA in financing adaptation and on the mobilisation of other financial resources.

With respect to climate change in Africa, the OECD-hosted Africa Partnership Forum notes in a recent paper titled Climate Change and Africa that although it is the continent least responsible for climate change, it is acutely vulnerable. Climate change is having adverse effects on economic growth and sustainable development, on poverty reduction, on human security, and on the prospects of achieving the MDGs. The impacts range from energy shortages, reduced agricultural production and worsening food security, to spreading disease and humanitarian emergencies, growing migratory pressures and increased risk of conflict over scarce land and water resources. Africa is the continent least able to meet the costs of adapting to these impacts, with the greatest need to develop its energy sources. Yet it is also the continent which receives least from current carbon finance mechanisms.

Urgent action is needed. More needs to be done to reduce future emission levels and to help Africa adapt to climate change. The response needs to take into account not only Africa’s acute vulnerability but also its legitimate development needs and the significant additional financial burden adaptation will create, estimated by the Intergovernmental Panel on Climate Change (IPCC) to be as high as 5 – 10% of the continent’s GDP. The focus of efforts now needs to be on mainstreaming adaptation in national planning and marshalling support for climate risk management in Africa. Africa should also contribute to mitigation efforts and promote clean energy development.

3. Other key challenges: fragile states and pro-poor growth

**The challenge of fragile situations and post-conflict States**

In preparing for the forthcoming High Level Forum on Aid Effectiveness in Accra, Ghana, the OECD’s DAC has taken stock of progress made in situations of fragility and conflict since the Paris Declaration was signed in 2005.

At the policy level, significant progress has been made. The OECD DAC Principles for Good International Engagement in Fragile States and Situations, approved by Ministers in April 2007, are widely acknowledged as the international reference point to guide external interventions in conflict-affected and fragile situations. Over the past three years, the Principles have systematically shaped both multilateral and bilateral policies in this area of work, most of which acknowledge the priority focus on peace and state building. Work in the OECD is underway to advance a more consistent and common understanding on state building in fragile contexts and how donors can best support it. The emerging understanding highlights the fact that state building concerns political processes of negotiation and contestation between the state and societal groups. These challenges are multi-dimensional and require coherent approaches that link various policy communities including defence, diplomacy, development, humanitarian assistance and trade. To that end several donors have established whole-of-government mechanisms at headquarter level and some have translated them into country-level strategies and instruments such as joint analytical frameworks, planning tools and pooled funding and staffing arrangements.
DAC members have responded to the challenges of fragile situations with more aid (Figure 2). But 75% of aid flows to fragile states have significantly benefited only five countries (Figure 3) and aid still tends to tail off just at the point when countries can use it most. Beyond aid volumes, what also matters is that countries should be able to access timely and appropriate types of aid and advice, accompanied by other forms of help such as over-the-horizon security guarantees or the prompt clearance of arrears.

<table>
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<tr>
<th>Figure 2: Increasing net ODA to fragile states</th>
<th>Figure 3: Half of net ODA excluding debt relief benefited just five out of 38 fragile states in 2006</th>
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Source: OECD-DAC Statistics

By contrast with the important gains made at the policy level, implementation at the country level remains weak. Overall, OECD governments are too often risk-averse, and respond too slowly and in an uncoordinated manner to many situations of conflict and fragility. Humanitarian, peace-keeping and development interventions are often not appropriately sequenced. Some multilateral donors have designed rapid response instruments, aligned to partner government requests, but more often than not recovery efforts have lagged seriously behind security interventions. Examples of effective whole-of-government approaches on the ground are rare.

Important challenges remain in several areas. First, more coherent and decisive strategies are required to address development needs in extreme situations of authoritarian governance. Second, a conflict and governance lens should be applied to traditional development programmes, such as education, health and infrastructure, with particular attention to vulnerabilities of women and youth. Third, there is need for deeper engagement with individual non-DAC donors that play an important role, politically as well as financially, in situations of conflict and fragility. Fourth, policies to address the coherence and sequencing between humanitarian responses, early recovery efforts, and longer-term development strategies are needed, along with associated financing and implementation modalities.

Finally, there is an urgent need for a new consensus on a realistic and transparent set of international objectives for state building, peace building and conflict prevention, accompanied by appropriate measures of progress. Such a consensus could provide the basis for focusing on a range of resources (both ODA and non-ODA) and on common priorities (e.g., a disarmament, demobilisation and reintegration programme (DDR). The OECD’s DAC is prepared to facilitate such a process with other partners.
Empowering the poorest: fostering pro-poor growth

There is now ample evidence to show that rapid economic growth is essential to meet the poverty reduction MDG. But more than that, we need growth that is broad-based and includes the activities in which poor women and men earn their livelihoods. And we need to help poor people (as workers and entrepreneurs) better connect up to the opportunities provided by growth. DAC work in this area demonstrates that key elements of such a “pro-poor” growth approach include:

- providing a conducive environment for the development of the private sector - the major contributor to growth and the creation of more and better jobs;
- expanding and maintaining accessible and affordable infrastructure, not only to remove bottlenecks to growth and reduce production and transaction costs, but also to help connect poor people to larger and more competitive product and factor markets;
- developing agriculture, as this is where most poor women and men are economically active and because national development generally occurs through increases in agricultural productivity coupled with an expansion in off-farm job opportunities;
- harnessing international trade and investment linkages are also important because these can increase demand for a range of local goods and services and raise productivity;
- developing social protection programmes that help to make growth more pro-poor (e.g. by tackling risk and vulnerability to encourage household livelihood decisions more likely to reduce poverty).

Despite this clear understanding of the issues, there are serious obstacles to implementing pro-poor growth approaches. Empowering the poor, especially women and marginalised groups, and giving greater voice to the many small and mostly informal enterprises operating in developing countries, is essential. It will help to identify binding constraints to growth and ensure that reform processes are transparent and accountable to the interests of the poor. The resulting policy and institutional reforms may mean that those currently benefiting from growth get less, which makes pro-poor growth a fundamentally political economy issue. Taking on such entrenched interests and inertia will require political will, drive and leadership.

4. To meet development targets we need more predictable aid and other sources of finance

Increasing predictability of aid: essential to effective budgeting

Heads of State remain politically committed to steep aid increases, and targets have helped to sustain the growth in underlying ODA by several donors. But they imply concrete budget and programming actions on both donor and partner country sides of a scope and magnitude that still often elude us. We need to focus on how we can build the development co-operation partnerships and processes needed to make larger increases in aid feasible.

These partnerships are essential to medium term planning of the investments required to help more countries meet the Millennium Development Goals (MDGs). Such planning requires above all improvements in the medium-term predictability of aid flows. Improving the predictability of aid flows in this way is key to enabling multi-year budgeting by finance ministers so that they can plan and make the investments required to achieve the MDGs. Working with the UN Secretary-General and other heads of
international development institutions, the OECD will be helping donors to remove remaining impediments to providing details of future spending intentions at the country level so that scaled up aid can be used to the best effect. This will go a long way to repairing what might be called an “information failure” in the aid system, which prevents the medium-term planning for scaling up that is needed to tackle effectively and sustainably the major development challenges in the poorer countries of our world.

As part of monitoring the delivery of the scaling-up promises and their allocations, the DAC Secretariat conducts an annual Survey of Aid Allocation Policies and Indicative Forward Spending Plans. The aims of the Survey are twofold: (i) to provide a global perspective of future aid flows, which will help to identify resource gaps and opportunities for scaling up in individual partner countries, and (ii) to improve the medium-term predictability of aid as called for in the Paris Declaration on Aid Effectiveness. The first Survey was carried out late in 2007 and covered 33 donors (DAC donors, multilateral organisations and global funds). An update to the survey was launched in early 2008 to improve the coverage, in particular by including data for the UN agencies.

The 2007 Survey results will be published early in May. They show that most donors have multi-year programming frameworks in place, which include information on planned expenditure. These frameworks mean that, at least as far as the priority partner countries of DAC members are concerned, there is now an informed dialogue on future aid levels. While the Survey findings are still to be finalised, they show that so far donors have programmed only around an additional USD 11 billion into their planned annual spending by 2010, on top of the extra USD 5 billion for country programmes that they delivered in 2005. This demonstrates that efforts to increase aid are being factored into some donors’ forward planning, but it still leaves up to USD 34 billion in 2004 dollars – about USD 38 billion in 2007 dollars – to be programmed into donor budgets if the commitments for aid levels in 2010 are to be fully met.

These results do not reflect the recent record donor pledges for IDA 15 (up 30% over IDA 14) and AfDF XI (up 52% on AfDF X) and the promising replenishment discussions for ADF X, as these replenishments will lead to new commitments that, in the main, will turn into expenditure in countries after 2010.

The IDA replenishment also provides an indication of the growing importance of non-DAC sources of finance, with China becoming an IDA donor for the first time, along with five other countries, bringing the number of non-DAC contributors to 23 countries. The OECD’s DAC recorded flows from non-DAC donors of over USD 5 billion in 2006, to which the Global Monitoring Report adds an estimated USD 3 billion from China and India.

**Other sources of finance**

OECD data record that grants from NGOs in DAC countries reached nearly USD 15 billion in 2006. This includes some funding from foundations, though it is not certain that all of this is captured in the statistics. The role of foundations is growing: the Gates Foundation alone expects to grow from the USD 1 billion it disbursed in 2006 to USD 3 billion in a few years. Corporate giving, for which there are no readily available data, is also significant.

Remittances provide another source of foreign funds. It is estimated that registered remittances reached USD 240 billion in 2007; more than twice the level of ODA. Many of these flows come from emerging economies themselves that are providing employment opportunities within the developing world. The key question here is to develop the proper institutional support to help local communities in poor countries turn part of these remittances into productive development projects. In some countries, like Mexico for example, local governments are already working in this type of schemes, with the support of international organizations and migrants associations in the United States.
Sovereign Wealth Funds (SWFs) can also become another powerful development engine. The OECD has been debating and exploring, along with the governments of other partner non-OECD countries—Brazil, China, India, Indonesia, Russia and South Africa— the best ways to react to SWFs. The central message reflects a clear commitment by OECD countries to keep their investment frontiers open to these funds, while we strengthen our multilateral effort to increase their transparency and reliability. SWFs bring benefits to home and host countries alike. They help to recycle savings internationally, and they contribute to economic development in their home countries. They can help shield economies from volatility in commodity markets while improving the risk-return profile of government-controlled portfolios. Knowing the enormous volume of these funds, we must consider their potential as development catalysts and find innovative ways to seize this potential. The OECD will be finding answers to this and other crucial SWFs issues through an open and inclusive dialogue among the major players.

While this growing diversity in the possible financial sources for development is welcome, many countries will require help to manage its complexity, and the menu of suitable options will vary from country to country depending on specific circumstances. More than ever a ‘one size fits all’ approach will not do.

The Doha Financing for Development review conference in November will offer an opportunity to examine the full—and growing—panoply of financing instruments that benefit developing countries. In addition to the more traditional sources noted above, these include innovative finance solutions, such as guarantees to leverage private investment.

5. We also need to improve Aid effectiveness

Improving Aid effectiveness is fundamental to maximize the impact of limited resources. But it is also essential to legitimate (and increase social support for) development policies in donor countries.

**AAA – The Accra Agenda for Action**

In September 2008, ministers from over 100 countries, heads of bilateral and multilateral development agencies, donor organisations, and civil society organisations (CSOs) from around the world will gather in Accra for the third High Level Forum on Aid Effectiveness. Their common objective is to help developing countries and marginalised people in their fight against poverty by making aid more transparent, accountable and results-oriented. The third High Level Forum (HLF) will: (i) review progress in improving aid effectiveness; (ii) broaden the dialogue to newer actors; and (iii) chart a course for continuing international action on aid effectiveness. With three major international events taking place in the second half of this year, 2008 provides us with an unprecedented opportunity to advance development and improve the effectiveness of aid. The Accra HLF will be followed by the United Nations Millennium Development Goal summit and the UN Financing for Development review conference in Doha. We will not make significant progress against the MDGs if we do not better combine quality and quantity of aid.

The Accra Agenda for Action (AAA) will be the main output of the HLF and will be developed through a broad-based process of dialogue at both country and international levels (the draft AAA is attached as Annex B). The purpose of the AAA is to deepen implementation of the Paris Declaration with a view to achieving the targets that were agreed in 2005. The AAA will also need to respond to emerging aid effectiveness issues diagnosed since 2005. Partner countries have identified six key areas where they would like to see improvements in the quality of aid (conditionality, multiannual predictability of aid, untying, complementarity/division of labour, incentives for donor staff to implement the Paris Declaration and capacity development). In recent gatherings, donors, partners and CSOs have all called for more ambition in the AAA—a welcome sign that a broad range of actors are serious about delivering better aid.
practice at Accra. At its High Level Meeting on 21 May, the DAC will discuss aid effectiveness – including aid untying, aid architecture and whole-of-government approaches to fragile states – and will signal the actions they are willing to take to address the priorities raised by partner countries.

A survey of country-level practice on the Paris Declaration is currently underway. It will, by July this year, provide up-to-date information on how far the commitments made in 2005 are being met. Without significant and ambitious progress we will face severe criticism from partner countries and CSOs. The Accra HLF provides us with a unique opportunity to demonstrate our political resolve by reaching ambitious agreements on better aid.

**Aid untying**

Untied aid is more effective aid. Open, international competition for procurement assures value for money and aid that is not tied to procurement in the donor country strengthens developing country ownership of aid. Developing countries consistently state that tying aid seriously undermines aid effectiveness. Progress on untying aid has been made – up to a point. OECD DAC members have untied their aid as required under the 2001 Recommendation on Untying Aid to the Least Developed Countries, and many donors have gone well beyond those requirements to untie all or most of their programmes. Reporting issues, however, hinder monitoring progress on untying and from engaging in more effective policy discussions. In 2006, we did not know the tying status of 44% of bilateral aid, either because DAC members do not have to report tying status (e.g. the case for technical co-operation) or because they simply do not report it. Of the remainder, 53% was untied in 2006, and 3% was reported as tied.

The share of bilateral aid that is untied is one of the MDG indicators, while the Paris Declaration includes a target (No. 8) on continued progress over time” in the “percentage of bilateral aid that is untied”. Monitoring and measuring progress on these indicators is thus statistically difficult.

Many developing countries are asking for real progress on aid untying by the time of the Accra HLF in September. Yet progress in reaching consensus in the DAC on untying more aid has been very slow and very limited. To date, the DAC has only reached agreement, in 2005, to abolish the thresholds below which aid covered by the 2001 Recommendation did not have to be untied. No progress has been made on areas not covered by the 2001 Recommendation, such as developing countries outside the least developed countries (LDC) group, technical co-operation or food aid. Present discussions in the DAC to expand the coverage of the Recommendation, which have been conducted on the basis of the likelihood of consensus and the magnitude of potential benefits, cover the following two areas:

- Proposals to increase the use of partner countries’ procurement systems and promote more local and regional procurement in developing countries when procurement is still managed by donors.

- A proposal to extend the coverage of the Recommendation to include those highly indebted poor countries (HIPC) not already covered by way of their LDC status. This proposal covers Bolivia, Cameroon, Côte d’Ivoire, Ghana, Guyana, Honduras, Nicaragua and Republic of Congo. While there is broad support in the DAC for this measure, there is still not a consensus to agree to it.

**Aid architecture issues**

As noted previously, there is a growing proliferation of development actors. Diversity and competition can be good if they improve choice and increase the overall resources for development. In many countries, however, a surfeit of donors risks undermining the weak capacity of the government to manage them. Donors are tackling this increasing fragmentation of aid by examining more specialisation by
country and sector through increased division of labour. There are promising initiatives such as the EU Code of Conduct on the Division of Labour in Development Policy, delivering as ‘One-UN’ at the country level, and work by some donors in the Multilateral Organizations Performance Assessment Network (MOPAN), to assess and improve the effectiveness of multilateral organisations, with a view to reducing overlaps and possible rationalisation. The DAC High Level Meeting will examine these issues as part of its preparations for the Accra HLF.

**Effective aid management: 12 lessons from OECD DAC peer reviews**

Faithful to its tradition, the *Development Co-operation Report 2007* is characterised by open reporting which has been at the heart of the DAC’s work from its inception. The importance of this is all the more evident as we look forward to key international events in 2008. The OECD’s DAC peer reviews remain an important source of insight on the effectiveness of aid and on how bilateral development co-operation systems are managed. They look carefully at the aid practices of the country under review with a view to improving their efficiency and effectiveness. Looking across the reviews can help us understand what seems to work: what are critical factors to good aid management. The *Development Co-operation Report 2007* does just that. It takes a look at a full cycle of peer reviews and distils twelve key lessons (Box 1) on how aid can be effectively managed to produce results. These lessons can be grouped into three categories: strategy, organisational management and management of delivery.
Box 1. Effective aid management: 12 lessons from OECD DAC peer reviews

- **Lesson 1:** Have a clear, top-level statement of the purpose of development co-operation, whether in legislation or another form, that has wide ownership and can remain relevant for a sufficient period.

- **Lesson 2:** Avoid letting short-term pressures jeopardise the long-term common interest in effective development.

- **Lesson 3:** Set a clear mandate and establish mechanisms to ensure that policies are assessed for their impact on poor countries.

- **Lesson 4:** Invest in delivering, measuring and communicating results of aid-financed activity.

- **Lesson 5:** Task a sufficiently senior and publicly accountable figure with clear responsibility at the political level for delivery of effective development co-operation.

- **Lesson 6:** Rationalise bilateral aid structures to facilitate coherent action at country level.

- **Lesson 7:** Promote coherence between those responsible for different aspects of multilateral aid.

- **Lesson 8:** The decentralisation of responsibility to the field can be beneficial, but it needs high-quality, lean supporting systems.

- **Lesson 9:** Radical reforms in aid delivery will be vital as donors are forced to deliver more aid per head of agency staff, while increasing the effectiveness of this aid.

- **Lesson 10:** Most DAC members should focus their assistance on fewer countries, fewer sectors and, in particular, fewer activities.

- **Lesson 11:** Develop a stronger culture of managing for results and align incentives accordingly, but in ways that promote, not weaken, local structures of accountability.

- **Lesson 12:** Securing and developing well-qualified, well-motivated local and expatriate staff is essential for any agency to function effectively. The good news is that quality agencies attract quality staff.

We find that development co-operation, for many DAC members, is a key part of foreign policy, and that development co-operation also competes with other national interests. To manage these relationships, a sound legal and political foundation is imperative to development co-operation finding its appropriate place among competing national interests and within policy coherence. Gaining public support for development co-operation is also fundamental. Strong public support is the best guarantee for political and legislative support for sound and dynamic national development programmes.

The aid effectiveness agenda is leading to reform in many DAC members’ aid administrations. A couple of lessons are well worth mentioning in this context: first, it is important to identify a leadership structure that works, *i.e.* task a sufficient senior and public accountable figure with clear responsibility at the political level for the delivery of effective development co-operation. Second, avoid institutional dispersion, and rationalise bilateral aid structures, especially for action on the ground, and decentralise as much as possible to the field.

One lesson relates directly to contributions to multilateral organisations: we find in almost all the aid reviews that there is a need for stronger strategic and operational connections between the bilateral and multilateral sectors of the aid system. OECD DAC members contribute a significant share of their ODA
to multilateral institutions – to the European Community, the UN family, and indeed, to the World Bank. In 2005, the DAC average multilateral contribution was 30% of ODA – not counting debt relief – although the range was from 9% to 83%. Links between the various facets of the aid contributions must be improved if we are to be effective within increasingly complex global aid architecture.

The aid reviews pay increasingly greater attention to aid effectiveness – both that achieved within agencies, and that delivered on the ground. In order to move in the right direction, donors must pay attention to how they deliver aid. As we scale up to meet international commitments, most are being asked to deliver more. They are also having to contend with – with less staff – national and expatriate – so it is especially important that these should be well qualified. Delivering aid in new ways as suggested by the Paris Declaration will help meet this challenge. Focusing on fewer sectors and limiting the number of partner countries will also contribute to effectiveness so long as a good division of labour does not leave some partners completely unattended by the aid community.

Finally, donors must continue to develop a stronger culture of managing for results and aligning incentives accordingly – in ways that promote, not weaken, partner country structures of accountability.

6. Partnerships for development

Achieving the MDGs

The OECD, together with the Bank, IMF, AfDB, AU, EC, and the Islamic Development Bank, is a member of the UN Secretary-General’s MDG Africa Steering Group and associated Working Group. We strongly support this major initiative by the international organisations to use this midpoint between the Millennium Declaration and the MDG target date of 2015 to stimulate action to help many more African countries achieve the MDGs. Our specific contribution is on improving both the volume and effectiveness of ODA, as called for in MDG 8. Our actions are described above, spurring DAC members to deliver on their pledges for increased aid, delivered more effectively. As part of the work on improving the predictability of aid (as also described above), the OECD will be helping donors to remove remaining impediments to providing details of future spending intentions at the country level so that scaled up aid can be used to the best effect.

The other direct OECD contribution to the MDGs is our work through PARIS21 (the Partnership in Statistics for Development in the 21st Century). P21 was founded in 1999 together with the Bank, the EC, the IMF and the UN and aims to promote the development and implementation of comprehensive national strategies for the development of statistics. As a result of this work, the underlying data used to monitor progress on national development strategies and the MDGs should dramatically improve over the remaining period to 2015. Consequently, countries can better plan and monitor their performance based on solid evidence, so that they, and their donor partners, can manage for development results and so maintain support for funding the investments – through domestic and external resources – required to help them achieve the MDGs.

OECD-World Bank cooperation

Co-operation between OECD and the World Bank Group has a long history and has intensified in recent years. The organisations have long had extensive co-operation in the field of development assistance and the Bank has been an active participant in the OECD’s DAC since its foundation. Co-operation encompasses a wide range of areas, including governance, trade, taxation, social protection, and investment climate. Following a meeting of senior officials in Washington D.C. on 5–6 December 2007, the OECD and the Bank agreed to step up their co-operation in a number of key areas, including efforts to promote sustainable and inclusive growth in emerging economies, the economics of climate change, aid
for trade, innovation and the design of comprehensive country frameworks for investment. It was also
agreed that special attention will be given to sharing experiences about how countries can best leverage
global economic integration while confronting the challenges of inequality and sustainability, an agenda
that cuts across economic, social and environmental dimensions.
Dear Ministers,

I am pleased to present to you the OECD Investment Committee’s report on “Sovereign Wealth Funds (SWFs) and Recipient Country Policies”. This report was prepared in response to the request of the G7 Finance Ministers and other OECD members last fall, for us to develop guidance for recipient countries’ policies toward investments from these funds. The OECD addressed this request as part of an ongoing project on Freedom of Investment and National Security, which was launched in view of the rise of investment protectionism and to maintain open markets.

The report is the result of the work of the thirty OECD countries, fourteen non-member countries participating in the project and the European Commission, and benefitted from consultations with SWFs and the business and social partners. I believe that this process is already helping to create a much better understanding of the issues involved for recipient countries, and I have no doubt that it will also help facilitate the work underway in the IMF for best practices by SWFs.

Our findings show that these funds bring benefits to home and host countries and that existing OECD investment instruments are well suited to develop guidance for countries receiving investments from SWFs. These instruments call for fair treatment of investors. They commit adhering governments to the principles of transparency, non-discrimination, liberalisation and standstill, and to build this fair treatment into their investment policies. They provide for “peer review” of adhering countries’ observance of these commitments.

The OECD investment instruments also recognise the right of countries to take actions to protect national security. Investments by SWFs can raise concerns as to whether their objectives are commercial or driven by political, defence or foreign policy considerations. In our report, the participants in the Freedom of Investment project agree that recipient countries should apply the national security clause of the OECD investment instruments with restraint. They have agreed on a number of key principles – transparency and predictability, proportionality and accountability – that should guide governments when they design and implement investment measures to address national security concerns. These principles should also apply when dealing with investments from SWFs.

Observance of high standards by SWFs and their provision of adequate and timely information will facilitate recipient countries’ efforts to implement their OECD commitments and its recommendations for preserving open markets while safeguarding national security. IMF findings on best practices for SWFs will be welcome in this regard.

The OECD will continue its work on how governments can maintain their commitment to open international investment policies – including for SWFs – while also protecting essential security interests. The resulting framework will foster mutually-beneficial situations where SWFs enjoy fair treatment in the markets of recipient countries and these countries can confidently resist protectionism pressures. To this end, the spirit of co-operation that has characterised these discussions to date will continue through consultation and dialogue between home and recipient countries and between the IMF and the OECD.

We will present the results of our work to the OECD Ministerial Meeting next 4-5 June. The final report of the Freedom of Investment project will be released in Spring 2009.

We look forward to continuing to work with you on this very meaningful project.

Sincerely,

Angel Gurría
OECD Secretary-General

Letter transmitting the Report of the OECD Investment Committee to G7 Finance Ministers.
SOVEREIGN WEALTH FUNDS AND RECIPIENT COUNTRY POLICIES

Report by the OECD Investment Committee

In recent years major changes in the environment for national security and the international economy have caused a number of OECD and other governments to reassess their investment policies. One important element in the changing global economy is the increasing prominence of Sovereign Wealth Funds (SWFs) from a wide range of home countries.

The mandate to the OECD

Since its creation, the OECD has been a strong advocate of free capital movements and their long term benefits. The OECD has been the primary international forum for policy analysis and development of guidance on good practices for investment policy. This guidance sometimes takes the form of authoritative, even legally-binding, government-backed investment instruments.

Because of this, the OECD has been asked by the G7 Finance Ministers and the other OECD members to develop guidance for recipient countries’ policies toward investments from SWFs. Follow-up on this mandate has been undertaken as part of the Investment Committee's project on “Freedom of Investment, National Security and ‘Strategic’ Industries” and has benefited from the participation of non-OECD countries. The project is independent from, but complements efforts underway in the International Monetary Fund (IMF) to develop voluntary best practices for SWFs.

This note explains the general context for this work, reports on its preliminary findings and describes the next steps.

SWFs bring benefits to both home and host countries

The rapidly growing number and size of SWFs reflect the growth in foreign exchange assets that accrue mainly via revenues from commodity markets or intervention in the foreign exchange market. Budget revenues are also important in some cases. SWFs represent efforts by owners of these assets to manage them in a more proactive and sophisticated way.

SWFs have much to offer. SWFs’ recent injections of capital into several OECD financial institutions were stabilising because they came at a critical time when risk-taking capital was scarce and market sentiment was pessimistic. They help to recycle savings internationally and generally have a good track record as long-term investors. They contribute to the economic development of their home countries; for example, they help to shield their economies from volatility in commodity markets, improve the risk-return profile of government-controlled portfolios and may boost financial and fiscal management capacities. In recipient countries, SWFs can also bring the benefits normally associated with foreign investment such as stimulating business activity and creating jobs. As one of the world’s main proponents of an open investment system, the OECD welcomes these benefits for home and host countries.

Existing OECD principles call for fair treatment of SWFs

But, as is often the case, when new actors emerge on the international financial scene, the players need to become better acquainted. The growing role of SWFs raises issues regarding the smooth functioning of financial markets and they raise investment policy questions, including legitimate concerns in recipient countries.
Box 1. The OECD acquis – established investment policy principles

The key OECD investment instruments are the OECD Code of Liberalisation of Capital Movements, adopted in 1961, and the OECD Declaration on International Investment and Multinational Enterprises of 1976, as revised in 2000. They have procedures for notification and multilateral surveillance under the broad oversight of the OECD’s governing Council to ensure their observance. The instruments embody the following principles:

- **Non discrimination.** Foreign investors are to be treated not less favourably than domestic investors in like situations. While the OECD instruments protect directly the investment freedoms of those SWFs established in OECD member countries, they also commit members to using their best endeavours to extend the benefits of liberalisation to all members of the International Monetary Fund. Experience has shown that, in practice, OECD governments nearly always adopt liberalisation measures without discriminating against non-OECD countries -- investors from non-member countries reap the same benefits of free market access as OECD residents. Outright discrimination against non-OECD based investors would be a major departure from OECD tradition.

- **Transparency.** Information on restrictions on foreign investment should be comprehensive and accessible to everyone.

- **Progressive liberalisation.** Members commit to the gradual elimination of restrictions on capital movements across their countries.

- **“Standstill”.** Members commit to not introducing new restrictions.

- **Unilateral liberalisation.** Members also commit to allowing all other members to benefit from the liberalisation measures they take and not to condition them on liberalisation measures taken by other countries. Avoidance of reciprocity is an important OECD policy tradition. The OECD instruments are based on the philosophy that liberalisation is beneficial to all, especially the country which undertakes the liberalisation.
National security is a legitimate concern but should not be a cover for protectionist policies

The OECD investment instruments recognize the right of member countries to take actions they consider necessary to protect national security (Article 3 on Public Order and Security of the OECD Codes of Liberalisation of Capital Movements and Current Invisible Transactions).

Investments controlled by foreign governments, such as those by SWFs, can raise concerns based on uncertainty regarding the objectives of the investor and whether they are commercially based or driven by political or foreign policy considerations. They can raise concerns with respect to foreign government control or access to defence related technologies -- for example, that such investments could provide a channel for the acquisition of dual-use technologies for military purposes by the acquiring country or for denying technology or other assets critical for national defence to the recipient government itself, or for aiding the intelligence capabilities of a foreign country that is hostile to the host country.

However, OECD members have agreed that the national security clause of the OECD investment instruments should be applied with restraint and should not be a general escape clause from their commitments to open investment policies.

Security-related investment safeguards should be made as open as possible

Since 2006, OECD and non-OECD countries have been discussing appropriate means to address legitimate national security concerns while preserving and extending the open international investment system. These discussions have taken place in the context of the OECD Investment Committee’s project on “Freedom of Investment, National Security and ‘Strategic Industries’” through a series of discussions held in conjunction with regular meetings of the Investment Committee. Best practices for recipient country policies toward SWFs are being taken up in the context of this broader discussion.

Surveys of the policies of participating countries and related analyses and discussions have revealed that most countries have one or more investment measures designed to safeguard national security. However, few presently have explicit policies regarding foreign government-controlled investors, such as SWFs. Four of the thirty members have laws restricting foreign government-controlled investors. One includes foreign government control as a public interest test for merger reviews under its competition law. Two explicitly mention such control as a factor to consider in their investment review processes. Several others have investment review processes that, because of their broad mandates, could include foreign government control as a factor, even though it is not explicitly identified.

Participants in the project have agreed on a number of key principles that should guide governments in the design and implementation of measures intended to address national security concerns in the context of foreign investment. These are transparency and predictability, proportionality and accountability. Participants consider that these principles are equally relevant to addressing national security concerns that arise in the context of investment from SWFs. Box 2 describes these principles and provides preliminary policy guidance based on the discussions to date.

The project includes a process of regular peer monitoring within which countries report measures in place or under consideration and receive feedback from their peers in light of the principles of transparency/predictability, proportionality and accountability and of OECD members’ commitments under the OECD investment instruments. The process has revealed that six OECD countries took new measures and that these measures were designed to codify or clarify existing laws. As part of its on-going work, the Committee will continue to monitor developments in this regard.
Box 2. Investment policy guidance from the freedom of investment project

Participants have agreed on the following guidance for investment policy measures designed to safeguard national security:

**Non-discrimination** – Governments should be guided by the principle of non-discrimination. In general governments should rely on measures of general application which treat similarly situated investors in a similar fashion. Where such measures are deemed inadequate to protect national security, specific measures taken with respect to individual investments should be based on the specific circumstances of the individual investment which pose a risk to national security.

**Transparency/predictability** – while it is in investors’ and governments’ interests to maintain confidentiality of sensitive information, regulatory objectives and practices should be made as transparent as possible so as to increase the predictability of outcomes.

- **Codification and publication.** Primary and subordinate laws should be codified and made available to the public in a convenient form (e.g. in a public register; on internet). In particular, evaluation criteria used in reviews should be made available to the public.
- **Prior notification.** Governments should take steps to notify interested parties about plans to change investment policies.
- **Consultation.** Governments should seek the views of interested parties when they are considering changing investment policies.
- **Procedural fairness and predictability.** Strict time limits should be applied to review procedures for foreign investments. Commercially-sensitive information provided by the investor should be protected. Where possible, rules providing for approval of transactions if action is not taken to restrict or condition a transaction within a specified time frame should be considered.
- **Disclosure of investment policy actions** is the first step in assuring accountability. Governments should ensure that they adequately disclose investment policy actions (e.g. through press releases, annual reports or reports to Parliament), while also protecting commercially-sensitive and classified information.

**Regulatory proportionality.** Restrictions on investment, or conditions on transaction, should not be greater than needed to protect national security and they should be avoided when other existing measures are adequate and appropriate to address a national security concern.

- **Essential security concerns are self-judging.** OECD investment instruments recognize that each country has a right to determine what is necessary to protect its national security. This determination should be made using risk assessment techniques that are rigorous and that reflect the country’s circumstances, institutions and resources. The relationship between investment restrictions and the national security risks identified should be clear.
- **Narrow focus.** Investment restrictions should be narrowly focused on concerns related to national security.
- **Appropriate expertise.** Security-related investment measures should be designed so that they benefit from adequate national security expertise as well as expertise necessary to weigh the implications of actions with respect to the benefits of open investment policies and the impact of restrictions.
- **Tailored responses.** If used at all, restrictive investment measures should be tailored to the specific risks posed by specific investment proposals. This would include providing for policy measures (especially risk mitigation agreements) that address security concerns, but fall short of blocking investments.
- **Last resort.** Restrictive investment measures should be used, if at all, as a last resort when other policies (e.g. sectoral licensing, competition policy, financial market regulations) cannot be used to eliminate security-related concerns.

**Accountability** – procedures for parliamentary oversight, judicial review, periodic regulatory impact assessments, and requirements that decisions to block an investment should be taken at high government levels should be considered to ensure accountability of the implementing authorities. Discussions of accountability under the “Freedom of Investment” project will take place in late 2008.
**Investors and home countries can ease concerns through transparency**

Although the OECD work focuses on host country policies, observance by SWFs of high standards of transparency, risk management, disclosure and accountability can affect the political and policy environment in which recipient countries act. In particular, observance of high standards by investors should positively influence how recipient countries implement their OECD obligations and OECD’s policy recommendations when they design and implement policies to address national security concerns while maintaining their commitment to open markets. The availability of adequate and timely information from SWFs, including their investment goals, facilitates this objective. In addition, contributing to greater confidence by recipient governments, observance of high standards of governance by such investors will also enhance their financial management and, more generally, their effectiveness in fulfilling their fiduciary responsibilities to their owners and shareholders and the expectations of other stakeholders.

**Next steps**

The OECD also supports the work underway at the IMF on best practices for sovereign wealth funds, calls attention to OECD’s voluntary standards on corporate governance and good business conduct, and notes their relevance to work underway at the IMF. These include the OECD Guidelines on Corporate Governance of State-Owned Enterprises, the OECD Guidelines for Multinational Enterprises and OECD pension fund-related guidelines. The OECD looks forward to the outcome of the IMF’s work and may consider the results in weighing any proposals made for future work in this area at OECD.

OECD will continue addressing this issue as part of the “Freedom of Investment” project in order to deepen consideration of how governments can maintain their long-standing commitment to open international investment policies -- including for SWFs -- while also protecting essential security interests.

The work programme will include further clarification of best practices regarding the implementation of the three guiding principles, especially “accountability”, and any additional work which may seem appropriate in light of the results of the IMF’s work.

The resulting framework will foster mutually-beneficial situations where SWFs enjoy fair treatment in recipient country markets and recipient countries can confidently resist pressures for protectionist responses. To this end, the spirit of cooperation that has characterised FOI discussions to date will continue through consultation and dialogue between home and recipient countries and between the IMF and the OECD.

Discussions under the Freedom of Investment project, which take place three times a year, will include a special session on government-controlled investors. Reports summarising the discussions held under the project will continue to be published. A final report on the Freedom of Investment project -- bringing together all of the findings of the discussions -- will be completed in mid-2009.

The resulting policy guidance will take the form of a menu of best practices which are consistent with existing OECD instruments and with the principles of transparency and predictability, proportionality and accountability. Its recommendations may also contain suggestions for appropriate revisions/clarifications to existing OECD instruments.
## FURTHER READING

The following material is available on the OECD website at [www.oecd.org/daf/investment/foi](http://www.oecd.org/daf/investment/foi), unless specified otherwise.

**Freedom of Investment, National Security and “Strategic” Industries: Progress Report by the Investment Committee, April 2008**

**OECD Roundtable VI on *Freedom of Investment, National Security and “Strategic” Industries*, 13 December 2007**


**Protection of ‘critical infrastructure’ and role of investment policies relating to national security, May 2008**

**Transparency and predictability for investment policies addressing essential security interests: A survey of practices, April 2008**

**Proportionality of measures: A survey of practices, May 2008**

**Competition, International Investment and Energy Security, April 2008**

**Consultations on Freedom of Investment, National Security and “Strategic” Industries: Submissions by BIAC [www.biac.org](http://www.biac.org) and TUAC [www.tuac.org](http://www.tuac.org)**


**Economic and other impacts of foreign corporate takeovers in OECD countries, *International Investment Perspectives, OECD, 2007***

**Essential Security Interests under International Investment Law, *International Investment Perspectives, OECD, 2007***