

OUTWARD FDI FROM EMERGING MARKETS: SOME POLICY ISSUES

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Outward foreign direct investment (OFDI) from emerging markets (essentially all non-OECD countries) has risen considerably during the past decade, reaching \$133 billion in 2005, for a stock of some \$1.4 trillion. As in the case of developed countries, the bulk of this investment is accounted for by a limited number of economies, with ten of them responsible for 83% in 2005. An increasing number of emerging market firms are joining the rank of multinational enterprises (MNEs), i.e. firms controlling assets abroad. This development raises at least two policy-oriented questions:¹

1. How should the policy regime for OFDI from emerging markets look like to support the competitiveness of the firms involved and the performance of their home countries?
2. How to manage the public reaction in emerging markets to their OFDI and in host countries to inward FDI from emerging markets?

1. THE POLICY REGIME FOR OFDI FROM EMERGING MARKETS

Governments of emerging markets seeking to establish a policy regime for OFDI face a dilemma. They may recognize that OFDI is important for the

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1 competitiveness of their firms. The reason is that a portfolio of locational
3 assets is increasingly important as a source of the international competi-
5 tiveness of firms as it provides access not only to markets but also to the
7 range of resources that are needed for the production process. This is
9 particularly important in a world economy that is open and in which
competition is everywhere, because of the liberalization of the trade, FDI
and technology regimes – in other words, foreign firms can compete with
emerging market firms on the latter’s home turf through imports, inward
FDI and technology-transfer agreements.

11 If emerging market firms cannot do the same – and, in the context of FDI,
13 if they cannot improve their competitiveness through OFDI – they are
15 handicapped: they are deprived of one source of competitiveness, namely a
17 portfolio of locational assets. This applies not only to production OFDI but
19 also to trade – supporting FDI.

15 Hence one side of the dilemma is that OFDI, as a source of the
17 competitiveness of emerging market firms, should be an option available to
19 these firms if and when they are required to take advantage of it. This is a
21 micro-level consideration related to OFDI from emerging markets.

19 The other side of the dilemma concerns the macro-level. More specifically,
21 most emerging markets perceive themselves as (and in most cases are)
23 importers of capital, not exporters of capital. This is so by virtue of being an
25 emerging market and, hence, typically facing a balance-of-payment
27 constraint. In any event, the priority for them is to build domestic
productive capacity and increase domestic employment; to do so abroad
appears, at a minimum, counter-intuitive and, at worst, unpatriotic.
Permitting OFDI – let alone encouraging it – is therefore not a natural or
logical thing to do. Most emerging markets, therefore, and not surprisingly,
have followed a restrictive policy towards OFDI.

29 How to resolve this dilemma between the micro-level competitiveness
31 requirements of firms and the macro-level development constraints of
33 governments?² One answer for many countries is to liberalize the OFDI
35 regime gradually, e.g. by permitting OFDI up to a certain ceiling (which can
be raised), allowing it in certain sectors that are priority for the host
country, or on meeting certain criteria (e.g. impact on employment, the
balance of payments).

37 But even phased liberalization raises a number of questions. For example,
39 how does a country protect itself against capital flight and round-tripping?
(A good part of Russian FDI in Cyprus, Chinese FDI in Hong Kong and
Brazilian FDI in taxhavens, for example, may well be of this nature.) What
are the risks when liberalizing OFDI in certain sectors and not others – for

1 the country (has it picked the right sectors?) and the companies involved (is
the competitiveness of companies in non-liberalized sectors compromised?)?
3 Should a country aim for a neutral OFDI regime or, like virtually all OECD
countries do, go all the way and protect and even facilitate OFDI?³ (Some
5 developing countries have moved in this direction, too).

In other words, there are a number of questions with which emerging
7 markets grapple – and we have no convincing answers, let alone solid policy
advice. This is a wide field for urgent policy-oriented research.

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2. HOW TO MANAGE THE PUBLIC REACTION TO OFDI FOR EMERGING MARKETS?

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15 To begin with, OFDI is not yet an issue in emerging markets – with the
emphasis being on “yet”. In the great majority of countries, little attention is
17 being paid to it, both by the public and the government. In fact, only a few
countries have a well thought-through policy in this area. These include
19 Singapore which seeks to develop, through OFDI, an “external wing” of its
economy, and China, with its “Go Global” policy.⁴ But most countries have
21 no coherent framework. Even in a country like Brazil, where the President
not long ago proclaimed that he would like to see a dozen well-known
23 Brazilian MNEs, there was no follow-up on the policy side.

This may change with the growth of OFDI from emerging markets, as the
25 magnitudes reached for individual countries can no longer be ignored.
Moreover, successful take-overs of firms in developed countries are almost
27 celebrated as national victories – witness, for example, the successful bid of
Tata (India) for Corus (Netherlands/UK) – which brings the issue to the
29 attention of the public.

The question is, of course, how long national pride in such “victories” can
31 trump the macro-economic side of the dilemma. For the public (and
especially trade unions), emerging markets are, after all, primarily capital
33 importing economies; consideration of corporate competitiveness may not
count much for it. Sooner or later, therefore, it is quite likely that the
35 question of how good OFDI is for emerging markets as home countries will
become a political issue in a number of these countries. (We are quite
37 familiar with this development as, at the end of the 1960s, and driven by
trade unions, there was a wide-ranging debate in the United States about the
39 merits of OFDI; a more recent example is the reaction, especially in the US,
to the offshoring of services.)

1 What this calls for is an informed debate in emerging markets that are
3 becoming home countries about the importance of OFDI and the role it
 plays in national development. We will need to undertake much more
 systematic research to be fully prepared for this debate.

5 There is also a host country side to OFDI from emerging markets
 that needs to be managed. Interestingly enough, the host countries that so
7 far have reacted most to such investment are developed countries –
 “interestingly” because it is these countries that, traditionally, have been at
9 the forefront of promoting a liberal FDI regime. Yet, there is a distinct
 move towards a kind of FDI protectionism in these countries, focused
11 largely on cross-border mergers and acquisitions (M&As), especially (but
 not only) by firms from emerging markets. This reaction is amplified when
13 strategic sectors or national champions are involved, and, in particular,
 when the acquirer is a state-owned company.⁵ The state-owned aspect
15 (as regards emerging market firms) has acquired a particularly sharp edge
 with the growth of Sovereign Investment Agencies which have considerable
17 resources at their disposal and, increasingly, seek to invest them in firms
 abroad. In the United States, this has already led to an expansion of the
19 mandate of the Committee on Foreign Investment in the United States
 (CFIUS). It is quite conceivable that a number of countries in Europe (if not
21 the European Union itself) may establish CFIUS-type screening mechan-
 isms. While, in principle, they would screen cross-border M&As from all
23 countries, chances are that the principal targets are those involving parent
 firms headquartered in emerging markets, and especially state-owned
25 enterprises among them.

 The reasons are manifold. Partly, there is a concern that emerging market
27 MNEs may have imperfect corporate governance standards or pay less
 attention than their Northern competitors to social, environmental and
29 human rights issues. In the case of state-owned enterprises, there is
 furthermore the concern that these may have easier access to finance and
31 hence be in a better position to prevail in M&A bidding contests. More basic
 is the fear that state-owned enterprises may not work according to the logic
33 of the market but rather manage their foreign affiliates in the interest of the
 policy objectives of their home country governments. And, most basic,
35 perhaps, emerging market MNEs are “the new kids on the block”. Since
 they are here to stay – and, in fact, bound to become more important as
37 emerging markets develop successfully – the challenge is to integrate them
 smoothly into the world FDI market. And, as we know from other contexts
39 (especially relations among states), integrating emerging powers in an
 established order is not easy, as it implies that the importance of other

1 players will be diminished, if they do not disappear altogether (e.g. through
M&As).

3 To manage the reaction in home and host countries to OFDI from
emerging markets presents therefore a set of challenges for which we need to
5 prepare ourselves. This is all the more important as OFDI is an additional –
and important – channel through which emerging markets are integrated
7 into the world economy. But it is also important because the rise of
emerging market MNEs, if not properly managed, could contribute to a
9 general backlash against FDI and the open regulatory framework that
governs it to a large extent.

11 These are two policy areas – the appropriate policy regime for OFDI from
emerging markets and the challenge of managing the public reaction to such
13 investment – that I think are among the key policy issues that need to be
addressed. They open a wide field for urgent policy-oriented research.

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19 Sauvant (2005); Sauvant (2006); Sauvant (2007); Sauvant (forthcoming).

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NOTES

25 1. For a discussion of the range of issues related to the rise of emerging market
MNEs, see Karl P. Sauvant, ed., *The Rise of Transnational Corporations from
Emerging Markets: Threat or Opportunity?* (London: Edward Elgar) (forthcoming),
27 as well as UNCTAD (2006), *World Investment Report 2006: FDI from Developing
and Transition Economies. Implications for Development* (Geneva: UNCTAD).

29 2. Besides, there is the question: is what is good for, say Infosys, also good for
India? After all, Infosys seeks to maximize its profits, and takes its decisions
31 accordingly. And, the more transnationalized Infosys becomes, the less likely it is
that its decisions will pay special attention to the requirements of India. As a global
player, its interests are global, not national.

33 3. This is examined by Theodore H. Moran, “What Policies Should Developing
Country Governments Adopt Toward Outward FDI? Lessons from the Experience
of Developed Countries”, in Karl P. Sauvant, ed., *The Rise of Transnational
35 Corporations from Emerging Markets: Threat or Opportunity?* (London: Edward
Elgar) (forthcoming).

37 4. See Karl P. Sauvant, “New sources of FDI: the BRICs. Outward FDI from
Brazil, Russia, India and China,” in the *Journal of World Investment & Trade*, vol. 6
(October 2005), pp. 639–709, available at <http://www.cpii.columbia.edu/>

39 5. This is part of a broader reaction to FDI, possibly even a backlash. See Karl P.
Savant, “A backlash against foreign direct investment?,” in Laza Kekic and

- 1 Karl P. Sauvant, eds., *World Investment Prospects to 2010: Boom or Backlash?*
 (London, UK: The Economist Intelligence Unit Ltd., 2006), pp 71–77, available at
 3 <http://www.cpii.columbia.edu/>. Also see Karl P. Sauvant, “Will a backlash trump
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