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Editor-in-Chief: Karl P. Sauvant (Karl.Sauvant@law.columbia.edu)
Managing Editor: Matthew Schroth (mas2443@columbia.edu)

A new challenge for emerging markets: the need to develop an outward FDI policy*

by
Karl P. Sauvant**

Practically all countries have policies, instruments and institutions to attract FDI and facilitate its entry, as such investment can contribute to their economic growth and development.

At the same time, FDI inflows for one country are FDI outflows for another country. During 2011-2015, 131 emerging markets[1] reported outflows at least for one of these five years. Outflows amounted to over US$ 400 billion in 2015, rising from 15% of world outflows in 1995 to 28% in 2015,[2] and undertaken by several tens of thousands of firms based in emerging markets. In other words, a large number of emerging market firms are sufficiently competitive to invest abroad.[3]

Yet, the policy picture on outward investment looks quite differently from that on the inward side.[4]

Virtually all developed countries have liberalized their outward FDI regime and have policies, instruments and institutions in place that address outward FDI. They differ by country, but they can include the provision of information, finance, fiscal advantages, and political risk insurance; international investment agreements that protect their outward investors; double taxation treaties that help to avoid double taxation; and various indirect supports, such as official development assistance linked to supporting donor countries' outward FDI projects, as well as help from private sector organizations such as bilateral chambers of commerce. All are geared toward facilitating, supporting or encouraging outward FDI by both private and state-owned firms. Often, small and medium-sized firms receive special support.

The situation is quite different in emerging markets.

A few economies, especially China, Malaysia, Singapore, and Taiwan, have elaborate policies, instruments and institutions supporting outward FDI. Typically, these are more recent, integrated in a development strategy and help private and state-owned firms.

The great majority of emerging markets, however, are still in the process of liberalizing their outward FDI policy regimes and have very few, if any, policies instruments and institutions in place.

Why?

Developed countries, as traditional capital exporters, support outward FDI for two principal reasons:

- To help their firms maintain or increase their international competitiveness through the establishment of networks of foreign affiliates that provide better access to markets and resources of all kinds. The assumption is that this, ultimately, benefits the home countries.

- To obtain direct access to natural resources and other assets (e.g., technology) important for their countries' economic growth and development.

The same considerations also apply, in principle, to emerging markets, as explicitly reflected in China's "going global" policy.[5] However:

- Officials of emerging markets are less confident that the impact of outward FDI on their economies is positive. Their focus is on encouraging investment at home; investment abroad is often seen as a substitute for, not as complementary to or supplemental of, domestic investment. They may consider outward FDI as cannibalizing exports, reducing employment, harming the balance-of-payments, or simply as capital flight.
- As they are recent outward investors, they have had little time or incentive to develop their own approach.

As a result, firms located in most emerging markets are at a competitive disadvantage when investing abroad: they do not benefit from the wide array of government support available to their competitors headquartered in developed countries and a few other emerging markets.

Governments of emerging markets should, therefore, consider developing policies, instruments and institutions that help their firms invest abroad to reap the benefits of outward FDI for their firms and economies. They need to appreciate that, for example, outward FDI may support exports (e.g., through various services, marketing, final assembly); provide (often through mergers and acquisitions) access to various resources, including technology, brand names and distribution networks; and expose their firms to pressures to be competitive in international markets. In doing so, the interests of firms seeking to invest abroad need to be balanced with the interest of governments seeking to build up domestic capacities, and the interaction between the two.

A carefully phased approach toward developing a policy toward outward FDI could begin modestly. For instance, governments could use their embassies to provide information to their firms about foreign investment opportunities. More generally, governments of emerging markets could profit from examining the policies of countries that have already developed their outward FDI policies, perhaps in the framework of a series of workshops organized by an international organization.

The more emerging market firms invest abroad, the more urgent it will become for their governments to develop an outward FDI policy—lest their most competitive firms remain at a disadvantage vis-à-vis their competitors headquartered elsewhere.

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** Karl P. Sauvant (karlsauvant@gmail.com) is Resident Senior Fellow, Columbia Center on Sustainable Investment, a joint center of Columbia Law School and the Earth Institute, Columbia University. The author is grateful to Roberto Echandi, Ravi Ramamurti and Lou Wells for their helpful peer reviews.

[1] *See* UNCTAD database, http://unctad.org/en/Pages/DIAE/World%20Investment%20Report/Annex-Tables.aspx. "Emerging markets" are all non-developed countries as defined by UNCTAD.

[2] Ibid.

[3] On the rise of emerging market firms, *see* Ravi Ramamurti and Jitendra V. Singh, eds., *Emerging Multinationals from Emerging Markets* (New York: CUP, 2009).

[4] For a review, *see* Karl P. Sauvant, Persephone Economou, Ksenia Gal, Shawn W. Lim, and Witold Wilinski, "Trends in FDI, home country measures and competitive neutrality," in Andrea K. Bjorklund, ed., *Yearbook on International Investment Law & Policy 2012-2013* (New York: OUP, 2014), pp. 3-107, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2814307.

[5] *See* Karl P. Sauvant and Victor Chen, "China's regulatory framework for outward foreign direct investment," *China Economic Journal,* vol. 7 (2014), pp. 141-163, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2354348.

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