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Outward FDI and a global compact on home-country investment incentives[*]

by
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Recognizing that not only inward FDI but also outward FDI (OFDI) can bring benefits for growth and productivity, governments are increasingly employing a wide variety of home-country measures to support or promote OFDI activities identified as beneficial.[1]

Not all home country measures are alike. Some (e.g., insurance schemes, the reduction of regulatory barriers, business support services) are likely to facilitate investment flows, if implemented in a transparent manner. Others (e.g., financial incentives) are more likely to produce undesirable distortive effects. The growing use of home country measures, accompanying the dramatic increase in OFDI during the past decade, has prompted discussions about the potential need for an international framework to discipline certain home country investment incentives.

There is indeed an urgent need to better understand the legal and policy implications of increasing OFDI flows for home countries and the challenges that OFDI incentives, especially in the form of financial and fiscal measures, pose for the international and national regulatory frameworks. Regulatory intervention must strike a balance between preserving, if not fostering, the benefits accruing to home countries from OFDI on the one hand, and reducing any distortive effects certain OFDI incentives may have for international investment, competition and trade, on the other.

As to benefits, although capacity constraints in developing countries may limit OFDI home country effects, evidence suggests that OFDI increases home country productivity, innovation and exports by allowing firms to grow bigger than they would have if limited to operating in their home market. This yields gains from economies of scale and lower production costs; fosters efficiency by contributing to home country firms' competitiveness in international markets; and promotes knowledge transfers.[2]

However, employing such home country measures as financial and fiscal measures to incentivize OFDI with the hope of reaping the above-mentioned benefits could have significant drawbacks. They include risks of abuse, waste, "beggar-thy-neighbor" policies, and negative effects on competitive neutrality. Sauvant and Boullanger suggest therefore an international multilateral (or regional) framework for disciplining OFDI incentives to solve these problems.[3]

While agreeing with the need for such an approach, the following should be considered to increase its feasibility:

- Credible (enforceable) disciplines, or even non-binding guidelines on best practices, must be inspired by evidence-based discussions. Thus, disciplining potentially investment-distortive incentives requires an in-depth understanding of the effects that these policy instruments exert on the home countries that grant them, the outward investors that receive them and third countries. A feasible "traffic-light" approach requires adequate data collection on investment-distortive incentives that can help distinguish between "good/tolerable" and "bad" OFDI incentives so as to devise adequate disciplines that limit the recourse to the former and discourage the latter.[4]
- Governments have a clear preference for preserving their policy space, and they have little interest in negotiating rules that erode it. Hence, discussions on an international framework for OFDI incentives may gain better traction if the availability of more reliable and comprehensive data allowed for the design of OFDI disciplines that limit the erosion of countries' policy space without unduly sacrificing the effectiveness of the disciplines themselves. For example, given that behavioral incentives tend to be more efficient than locational incentives, credible data would allow policymakers better to design disciplines targeting their distortive effects without unnecessarily frustrating their use.[5]
- Any international framework disciplining OFDI should be binding enough to minimize the risk of deviation on the part of governments, while flexible enough to allow home countries to pursue legitimate policy objectives. For example, GATS-plus disciplines on OFDI incentives in services could be implemented as binding additional commitments under GATS Article XVIII, with home country measures being potentially justified under general exceptions (GATS Article XIV).
- OFDI incentives may affect competitive neutrality, both across and within borders. Home country firms that benefit from OFDI incentives are placed in a more advantageous position vis-à-vis firms from countries that do not receive similar help from their governments. Similarly, home country firms that are eligible to receive them have an advantage over home country firms that are not—an issue that extends beyond state-owned enterprises (SOEs). Were international disciplines designed specifically to target the first distortion, they would fail to capture the competition-distortive effects that OFDI incentives may have for domestic rather than foreign firms. Likewise, SOE-specific disciplines may address only part of the problem.

Multilateral (or plurilateral) disciplines aimed at ensuring the proper implementation of OFDI incentives can help home countries reap the benefits of these measures, provided that discussions on their scope and design are evidence-based and engage the interest of a critical mass of willful countries.

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[1] World Bank, *Global Investment Competitiveness Report 2017/2018* (Washington, DC: World Bank, 2018), p. 102.

[2] World Bank, op. cit., pp. 115, 121.

[3] Karl P. Sauvant and Clémence Boullanger, "An international framework to discipline outward FDI incentives?," *Columbia FDI Perspectives*, No. 265, Nov.18, 2019.

[4] Evidence regarding the home country effects of OFDI for productivity, domestic investment, employment, and economic growth is still mixed; see, Pierre Sauvé and Marta Soprana, "Mission impossible? The political economy of disciplines on investment incentive," *Journal of World Trade*, vol. 52 (2018), p. 223.

[5] Ibid, p. 224.

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