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Research Report

The OFDI policy path and the product space

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Perspectives on topical foreign direct investment issues

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The OFDI policy path and the product space

by

Matthew Stephenson*

Outward FDI (OFDI) can be integrated in both national and corporate growth strategies.¹ As to the former, the key is to understand OFDI policy as progressing down a path that informs the selection of home-country measures (HCMs); target OFDI, to both leverage existing and develop new capacity; and ensure that investment and trade policies are aligned and mutually supportive.

The OFDI policy path. Economies such as China, India, Mexico, Poland, Singapore, Thailand, and the US have successfully integrated OFDI into their national development strategies, by following a four-stage pattern, characterized by the level of governmental support for OFDI:

- Removing some OFDI restrictions. As economies develop, policymakers start worrying less about capital outflows and more about competitiveness. Data show that economies remove OFDI restrictions as they develop, with developed economies having almost no restrictions in place.²
- Facilitating OFDI. Governments can facilitate OFDI, including by providing information and advice on FDI climates or through negotiating treaties, whether double taxation agreements or international investment agreements.
- Promoting OFDI. The level of support ramps up, moving from creating conditions for OFDI to actively promoting it. Non-financial support can include business missions, matchmaking or project development. Financial support can include guarantees, feasibility studies, office space abroad, loans, equity, and tax incentives.
- Calibrating OFDI support. Policymakers can calibrate OFDI support by reducing support or re-imposing some restrictions. Changing domestic economic priorities or concerns with business practices in foreign markets can precipitate this stage.

Visualizing this path can help policymakers identify the right OFDI policy and HCMs, depending on where an economy is along the OFDI path.

HCMs can range from relatively light to relatively heavy support.³ As economies move along, policymakers can add new “bricks” (i.e., HCMs) to increasingly support domestic firms to become outward investors.

To maximize OFDI benefits, policymakers should “lay bricks” both vertically and horizontally. Horizontal action means providing OFDI support that is sector agnostic. This opens the door to helping firms capable of investing abroad, but not operating within targeted sectors. Horizontal HCMs can include host country market information, match-making services, feasibility studies, and political-risk insurance.

Vertical action entails targeting sectors for OFDI support. To identify which sectors to target through vertical support, policymakers can use a simple exercise and an existing tool:

- Policymakers should list sectors they aim to grow and use OFDI to *develop new* capacity and competitiveness. HCMs can help firms use OFDI to target products that are closely related but slightly more complex than those they currently produce following the Product Space and the Product Complexity Index.⁴ Firms will be able to absorb the knowledge and technology embedded in the production of these goods and services, thereby helping them upgrade.
- Policymakers should identify sectors in which they are already competitive (e.g., using their revealed comparative advantage) and use OFDI to *leverage existing* capacity and competitiveness.

It is important to acknowledge that OFDI remains controversial and there can be trade-offs. Policymakers fear offshoring jobs and foregoing domestic investment. While benefits are not automatic, the evidence suggests that OFDI can generate positive effects through increased competitiveness, not just for outward-investing firms, but also spilling into home economies, including through increased productivity, innovation, exports, revenue, and job upgrading.⁵

As a result, governments are beginning to organize themselves to support OFDI. Developing economies generally assign inward FDI (IFDI) and export promotion functions to different institutions. As economies develop, they often merge these institutions⁶ and add the OFDI support function⁷ to better actuate their strategy. For instance, the [Polish Investment and Trade Agency](#) was restructured in 2017 to combine export and investment promotion and a new department for OFDI was created.

To close with an example, policymakers and firms may develop the microchip industry by attracting FDI to develop capacity, plug into value chains by exporting microchips and use OFDI to both leverage existing capacity (e.g., opening a plant in an economy whose microchip industry is relatively less complex) and develop new capacity (e.g., acquiring a plant in an economy whose microchip industry is relatively more complex).

While this is not easy, with a clear framework in place, policymakers and firms can better align actions and resources and bring new OFDI tools to help economic growth and development.

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¹ [Matthew Stephenson and Jose Ramon Perea, “How to leverage outward FDI for development? A six-step guide for policymakers”, *Columbia FDI Perspective*, no. 242, Dec. 31, 2018.](#)

² [Jose Ramon Perea and Matthew Stephenson, “Outward FDI from developing countries” \(Washington D.C.: WBG, 2018\), p. 120.](#)

³ [Karl P. Sauvart et al., “Trends in FDI, Home Country Measures and Competitive Neutrality”, in *Yearbook on International Investment Law & Policy 2012-2013* \(New York: Oxford University Press, 2014\), pp. 7-11.](#)

⁴ [C. A. Hidalgo et al., “The product space conditions the development of nations,” *Science*, vol. 317 \(2007\), pp. 482-487.](#)

⁵ [Jan Knoerich, “Do developing countries benefit from outward FDI?,” *Columbia FDI Perspectives*, no. 234, Sep. 10, 2018.](#)

⁶ [OECD, *Mapping of Investment Promotion Agencies in OECD Countries* \(Paris: OECD, 2018\), p. 19.](#)

⁷ [Armando Heilbron and Hania Kronfol, “Increasing the development impact of investment promotion agencies” \(Washington D.C.: WBG, 2020\), pp. 183 and 192.](#)

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