POLICY BRIEFING 63

Economic Diplomacy Programme

March 2013

BRICS FDI: A Preliminary View

EDIP Research Team[1]

RECOMMENDATIONS

Recommendations to improve intra-BRICS investment include:

- Collaboration across research institutions in the BRICS to support dynamic peer learning.
- Comparative studies of investment frameworks, legislation and regulations.
- Analysis of the linkages between investment and trade, industrial and financial policies.
- Deeper understanding of factors influencing decisions of investors from the BRICS.
- Improved collection tools and techniques for investment statistics and information.
- Joint approaches to investment co-operation based on principles of sustainable and development-oriented FDI.
- Focus on FDI's value creation and beneficiation within the host country.
- Alternative approaches to investor–state dispute settlement among BRICS countries.

EXECUTIVE SUMMARY

Trade among the BRICS countries has shown progressive growth over the past decade. Although foreign direct investment (FDI) flows in all of the countries have increased, intra-BRICS flows do not correlate with trade figures. Overall, there is less clarity on specific detail of FDI flows among the five countries, and on how they can be encouraged. With respect to outward FDI, there seems to be little strategic policy direction. The policy briefing outlines the existing outward investment motivations and destinations for each of the countries, and the historical sources of FDI for the BRICS. It provides a series of policy recommendations, which are aimed at enhancing FDI flows among the BRICS.

BRICS INVESTMENT

With the fifth BRICS Summit upon us (26–27 March 2013), the shift in global economic power to the BRICS is clear.

Intra-BRICS trade has been growing well. According to Standard Bank estimates it reached $310 billion in 2012. In contrast, the BRICS investment story has not been as positive, though theoretically, the BRICS (as emerging economies) have comparative advantage investing in each other over their Northern counterparts. Dunning ascribes foreign direct investment to ownership, location and internalisation (the OLI Model)[2] which significantly shifts bargaining power towards emerging-economy multinational corporations (MNCs), leapfrogging some of the expected steps in foreign entry mode – exports, minority joint ventures, majority joint ventures, and mergers and acquisitions (M&As). Sun *et al.* propose that emerging-economy MNCs are mostly motivated by industrial factor endowments, dynamic learning, value creation, strategic assets, and institutional facilitation.[3]

BRICS INWARD AND OUTWARD FDI FLOWS

As the traditional sources of outward FDI slowed in reaction to the 2007–09 financial crisis, interest in the emerging economies' FDI trends intensified. Developing countries were affected only moderately by the economic slump (due in part to the one-year time lag). The BRIC grouping and South Africa, before it joined in 2011, were noticed for their regional economic leadership; contribution to global GDP; impressive trade performance; and for their notable inward FDI growth on average.

Table 1: Inward and outward FDI flows by country ($ million), 2005–11

	Country	2005	2006	2007	2008	2009	2010	2011
Inward FDI	Brazil	15,066	18,822	34,585	45,058	25,949	48,506	66,660
	Russia	12,886	29,701	55,073	75,002	36,500	43,288	52,878
	India	7,622	20,328	25,506	43,406	35,596	24,159	31,554
	China	72,406	72,715	83,521	108,312	95,000	114,734	123,985
	SA	6,647	-527	5,695	9,006	5,365	1,228	5,807
Outward FDI	Country	2005	2006	2007	2008	2009	2010	2011
	Brazil	2,517	28,202	7,067	20,457	-10,084	11,588	-1,029
	Russia	12,767	23,151	45,916	55,594	43,665	52,523	67,283
	India	2,985	14,285	19,594	19,257	15,927	13,151	14,752
	China	12,261	21,160	22,469	52,150	56,530	68,811	65,117
	SA	930	6,063	2,966	-3,134	1,151	-76	-635

Source: UNCTADSTAT, Database, http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx, accessed 22 February 2013.

Table 1 reflects the growing attractiveness of all five countries to foreign investors – even during the economic slump. Their respective investment climates have improved significantly over the past decade, including in terms of macroeconomic stability and a greater openness to foreign ownership of business assets. Sector and policy challenges remain.

Multilaterals and governments continue to tackle information deficiencies in reporting inward FDI flows. Outward FDI data is much more difficult to monitor – especially 'under the radar' transactions into specific destination countries.

UNCTAD asserts that, on a global level, emerging economies were responsible for over 28% of outward FDI from 2009–10. Outward FDI growth signals an economy's emergence as a global player, beyond initial forays through trade, being an irrevocable commitment to establishing productive resources in another jurisdiction.[4] Developing-country MNCs are better able to adapt to other developing host countries, since conditions, including prices, supply chains and the scale of production are similar – or comparable – to the MNC home country.[5]

BRICS OUTWARD FDI MOTIVATIONS AND DESTINATIONS

Historically outward investment from developing countries has been mainly within the same region. This 'neighbourhood effect' is associated generally with commonalities in language and culture and familiarity with location, climate and factors of production. Sample data[6] up to the late 1990s show intra-regional FDI flows among developing countries in Latin America and Asia dominated. By 2004–05 Africa and the Middle East began to attract developing Asian resource-seeking investors.

Sub-Saharan Africa (SSA) has the largest number of low-income countries in the world. However, its FDI inflows have not compared with other regions, even though many African economies have improved their business, political and macroeconomic environments, making them increasingly attractive. Recently China, India and Brazil have overtaken the traditional investors, especially in African resources sectors. This trend may be reversed once the EU, the US and Japan fully recover from the global economic slowdown.

China: China's 'going out' strategy has focused on expanding outward FDI, while making Chinese companies more competitive by acquiring strategic assets. Additionally, China is establishing six special economic zones in Africa.[7] African countries have criticised China's reliance on Chinese labour in preference to local unemployed workers.

China's investments in SSA have been mainly in the resources sectors (oil, mining and natural gas).[8] State-owned Chinese enterprises have tied resource investments to debt-financed infrastructure concessions, through soft loans backed by the Chinese government.

More recently Chinese investors have trended towards a more country-specific investment strategy, engaging closely with host country policymakers. In Ghana, Chinese investment has gone into agro-processing and garment manufacturing. In Nigeria and Zambia, Chinese investors' interests have been both in upstream and downstream sectors, where beneficiation is occurring, for example, through the development of a refining capacity in Nigeria and processing copper into electric wires in Zambia.

India: Traditionally, outward FDI from private MNCs has been resource-seeking or technology-seeking, in countries such as Libya, Gabon and Sudan, as well as Australia and Indonesia. India's preferred method of outward direct investment has been through joint ventures or wholly owned foreign subsidiaries, with export finance.

Since 1992 India's structural reforms included industrial deregulation, trade liberalisation and the relaxation of regulations relating to inward FDI. These reforms have improved the competitiveness of leading Indian companies that have become MNCs. Indian state-owned enterprises are increasingly involved in greenfield FDI.

Apart from FDI in oil, coal and metals, since 2006 Indian FDI has predominated in manufacturing (agricultural machinery, organic chemicals, drugs, medicines, refined petroleum) and services (business services, data processing, financial services, architectural and engineering services).

Brazil: Early Brazilian outward FDI was driven by energy and mining; but over 2006–11 FDI into these primary industries declined significantly in favour of investment in the financial services sector. Top sectors for outward FDI include mining, oil and gas, construction, banking, steel, and food and beverages. Top recipients include its neighbours in the Mercosur region, the US and Europe.

Despite strong diaspora ties with the continent, Brazilian FDI to Africa comprises just under 10% of total FDI outflows.[9] Since 2003 there have been 25 new Brazilian investments in Africa, mostly in resources – primarily in Nigeria, South Africa, Angola and Mozambique. Brazil was Africa's third-largest trading partner in 2010 and has amplified its involvement in African agriculture through trade and investment and increasingly in renewable energy.

There is no official outward FDI policy for Brazilian MNCs, but the Brazilian National Development Bank offers below-market interest rates to select companies.

Russia: Russia's outward investment has been characterised by the neighbourhood effect, to former Soviet countries. However, Russian MNCs have preferred buyouts or the establishment of new companies in the former Soviet mould.[10] Russian MNCs are generally large exporters and their motives are market-seeking. Other motivations include reducing the effect of the US and Europe's protectionism in the metals sector; securing exports against political instability in transit countries; asset-seeking motives in developed countries; and resource-seeking in Africa and Kazakhstan.[11]

Russian government support for outward FDI is reportedly absent, although there is state support for subsidiaries of large MNCs like LUKOIL and UC RUSAL. Information deficiencies about investing conditions and requirements for doing business abroad have been identified as crucial shortcomings, which are exacerbated by the limited overseas presence of Russian economic and trade representatives.

South Africa: As the economic and political dynamo on the African continent, South Africa is a leading source of FDI in other African countries. By 2005, 34 of Johannesburg Stock Exchange listed companies had projects in 27 African countries.[12] Outward FDI projects include mining, infrastructure, engineering, manufacturing, wholesale, retail, media and financial services.

No formal regulatory policy exists for South Africa's outward FDI flows, but the government has encouraged local companies to invest on the continent. The country's first generation bilateral investment treaties (BITs) signed shortly after the 1994 transition, mostly with European countries, will not be renewed until the completion of a BIT policy framework review. However, South Africa is considering a series of new generation BITs with those African countries viewed as key to its trade and economic strategy. Notably, the South African government recently tabled a Foreign Investment Bill, which focuses on inward FDI and investor protection.

Traditional sources of FDI in the BRICS

Generally, the evidence suggests that intra-BRICS countries' investment is not substantial. Traditional economies play a pivotal role in investment in the BRICS countries, with the EU-27, the US and Japan having been critical in this regard.[13]

The EU-27 in particular has been the largest source of FDI to the BRICS. The UK has been the biggest investor in Russia and China, Spain the biggest investor in Brazil, and Germany the biggest investor in India.[14] South Africa has benefited from nearly 80% of FDI inflows coming from the EU. With the cancellation of the BITs, existing investments are protected for an additional 10 years, but new investments are not.

US FDI has been directed mainly towards China, reaching its peak in 2008 prior to the global economic crisis, and falling to its lowest levels in the middle of the crisis in 2009.

Japanese FDI has been relatively diverse, destined for Brazil and increasingly for India; but mainly dominated by

China since 2003. Brazil and India competed effectively for Japanese FDI, whereas Russia and South Africa received relatively less of the incoming FDI from Japan.

Trade and FDI compatibility among the BRICS

Despite the indifferent FDI linkages among the BRICS, there is reason to believe that flows could increase in the future. In an initial study focused on imports, exports, inward FDI and outward FDI, SAIIA has used data from the International Trade Centre's Trade Map database, supplemented by the South African Reserve Bank data, to analyse the BRICS countries' trade and investment compatibility.

Apart from difficulties in obtaining recent data – as well as certain anomalies in which the 'benefactor' country also registers as the most preferred exporter, importer, FDI donor, or FDI host in one or more of the top three sectors – some interesting potential sectoral compatibilities arise.

Although the data suggests that China is its own top importer in electronic components, India is China's second-best importer in the chemicals industry. Russia is the top recipient of China's inward FDI in the business activities sector, and India has both China and Brazil as top recipients of its outward FDI in financial services. Based on the data, South Africa's top sectors for trade and investment are metals and resources. Brazil (a potential mining FDI recipient), Russia (a petroleum exporter) and India (a metal and metal products importer) are its top potential partners.

ENDNOTES

1 This briefing has been prepared by SAIIA's EDIP Programme. Contributors include Catherine Grant, Itumeleng Rantao, Lesley Wentworth, Chris Wood and Sven Schroeder.

2 Dunning JH, 'The determinants of international production', *Oxford Economic Papers*, New Series, 25, 3, 1973, pp. 289 –336; Dunning JH, 'Toward an eclectic theory of international production: Some empirical tests', *Journal of International Business Studies,* 11, 1981, pp. 9–31.

3 Sun SL *et al.*, 'A Comparative ownership advantage framework for cross-border M&As: The rise of Chinese and Indian MNEs', *Journal of World Business,* 47, 2012, pp. 4–16.

4 Hymer, as well as Antras and Helpmann, refer to FDI as ownership to compensate against the disadvantage of being foreign (Hymer SH, *The International Operations of National Firms: A Study of Foreign Direct Investment.* Cambridge, MA & London: MIT Press, 1976; Antras P & E Helpman, 'Global sourcing', *Journal of Political Economy*, 112, 3, 2004, pp. 552–80.

5 By, for instance, Wells L, *Third World Multinationals*. Cambridge, MA: MIT Press, 1983; Lall S, 'The rise of multinationals from the third world', *Third World Quarterly,* 5, 3, 1983 pp. 618–26; and Aykut D & A Goldstein, 'Developing country multinationals: South-South investment comes of age', Working Paper, 257. Paris: OECD Development Centre, 2006.

6 Andrés MS *et al.*, 'What drives FDI from non-traditional sources? A comparative analysis of the determinants of bilateral FDI flows', *Economics*, 7, 2013-1, 2013, pp. 1–53.

7 Levesque G, 'Here's what's driving China's investments in Africa', *Business Insider Online*, 27 June 2012.

8 Mlachila M & M Takebe, 'FDI from BRICs to LICs: Emerging growth driver?', IMF Working Paper WP/11/178. Washington, DC: IMF, 2011.

9 De Abreu Campanario M *et al*. estimate that Africa received below 1% of Brazilian FDI between 2001 and 2008 (De Abreu Campanario M *et al*., 'Foreign Direct Investment: Diagnosis and Proposals for a Brazilian Public Policy', *Internext – Revista Eletrônica de Negócios Internacionais da ESPM*, 6, 1, 2011, pp. 125–58). The Africa Business Club at Harvard Business School puts this estimate at 6% in 2009 (Africa Business Club, *Post Conference Brochure of The 14th Annual Africa Business Conference*, 2–4 March 2012, Boston MA, Harvard Business School).

10 Kuznetsov A, 'Outward FDI from Russia and its Policy Context, Update 2011'. Columbia FDI Profiles, 2 August 2011.

11 *Ibid.*

12 Labour Research Service and Friederich Ebert Stiftung, *South African MNCS in Africa – Trends in 2010 / 2011: A report covering MNCs submitted by Global Unions*. Cape Town: Labour Research Service, 2011.

13 Mlachila M & M Takebe, *op. cit.*

14 Eurostat, *EU-27 Foreign Direct Investment in BRIC Countries.* Data in Focus, 29/2010. Luxenbourg: European Commission, 2010.

The Economic Diplomacy Programme is funded by the Swedish International Development Cooperation Agency, the Danish International Development Agency, the UK Department for International Development and the Swiss Development Corporation, which generously support the EDIP Programme. SAIIA gratefully acknowledges this support.

© SAIIA 2013 All rights reserved. Opinions expressed are the responsibility of the individual authors and not of SAIIA.