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Foreign Direct Investment Flows between the EU and the BRICs

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Contents

List of Tables, Figures and Boxes

Abstract

On a global level, the EU emerges as the most important foreign direct investor, also if considering extra-EU investments only. This reflects the capability and propensity of EU firms to internationalize their business activities. A joint analysis of two methodologically very distinct databases – Eurostat FDI data for FDI flows and stocks, and the FDI Intelligence from Financial Times Ltd. for the number of investment projects – made it possible, for the period 2001-2007 and 2003-2008 respectively, to reveal several facts and trends concerning the competitive position of EU firms in the BRICs and vice versa.

The EU is among the main investors in each of the BRICs and the dominant investor in Brazil and Russia. In China and India, the EU has less weight. But after correcting for particularities in FDI data, such as the prominent role of Hong Kong and off-shore centres in Chinese FDI and of Mauritius in Indian FDI, the EU ranks higher also in these countries. In a direct comparison with the US and Japan, the EU emerges as the leading investor among the Triad countries in each of the BRICs. This suggests that EU firms are well positioned to compete with other multinational corporations in the BRICs. The analysis of the number of projects confirms this finding, the role of the EU in China is much greater than suggested by FDI data. China emerges as the main BRICs target for EU projects, but in terms of FDI inflows China occupies rank three after Russia and Brazil. The divergent results can be explained by the small number of very large projects in the natural resource sector of Russia and the great number of finance- and trade-related small investments in China. In some cases, FDI has become the major entry strategy of EU firms into the BRICs markets.

A breakdown of EU investment in the BRICs by broad sectors reveals that approximately one third of the EU's FDI is in manufacturing and 60% in the services sector. This result emerges from both databases, although differences exist on a more detailed level.

Global and EU-15 investments in the BRICs, as measured by the number of investment projects, were resilient to the global crisis until 2008. With regards to the current economic downturn and the expected drop in global FDI, the BRICs may find themselves in a privileged position in several respects. First of all they are large economies where FDI is mainly attracted by the local markets with growth expectations above world average, although not in Russia. Local economic growth especially in China and India will allow for FDI to grow if companies from crisis-hit countries are in the position to invest. Larger multinationals may increasingly concentrate on the very few countries in the world where they can expand sales, such as China, India and Brazil, and shift investments there. Also for European companies the expansion to the BRICs remains a major attraction. Due to the size of the BRICs and their distance to Europe, only larger or more specialized investors may benefit from this opportunity.

The main conclusion based on the statistical analysis is that the EU is well positioned as a direct investor both on the global level and in the BRICs. In the fast growing markets of China and India, however, the share of EU firms in total FDI is rather low and not particularly dynamic. As investments in such geographically more distant places are mainly realized by large corporations while SMEs typically limit their foreign operations to nearby countries, policy levers may be necessary to expand EU presence there. This is all the more desirable as China and India have a high market potential and EU firms can expect high returns on FDI.

Policy obstacles to EU FDI in the BRICs exist in the form of various restrictions. FDI is limited in several industries important to EU investors, such as finance or telecommunications. EU trade policy should seek to eliminate such obstacles, including caps to foreign ownership. Restriction of foreign ownership can also not be in the interest of the BRICs in instances where it blocks the transfer of technology. The guidance for EU policy has been its strong commitment to open markets and fair competition and this may prevail over other concerns when dealing with investment issues of the BRICs. The EU may thus be interested in a process of further mutual and balanced liberalization in the area of FDI to eliminate obstacles on both sides.

Keywords: *FDI, competitiveness, EU, BRICs*

JEL classification: *F21, O52, O53, O54*

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Foreign Direct Investment flows between the EU and the BRICs

1 Introduction

Foreign direct investment (FDI) has become the major pillar of internationalization for firms. Although global FDI flows are still much lower than trade flows, FDI can be seen as the main channel of international competition. Firms undertake FDI primarily in order to expand and compete with domestic and other firms on the respective markets. An adequate measure of the relative importance of international trade and FDI in the international competition of firms is the ratio of sales of foreign subsidiaries (affiliates) established by multinational companies (MNCs) in foreign markets to exports. Such a comparison shows that sales of foreign affiliates surpass by far world exports (Sauvant, 2005). For the United States the ratio between sales of foreign affiliates abroad and exports stood at over 2.5 in 2006, and in the case of Germany (still holding the title of the world export champion) outward foreign affiliate sales clearly exceed exports of goods and services.[1]

In the case of services, a local presence often represents the sole possibility to enter a market because of the high degree of personal contact required (e.g. retail banking, restaurants, hotellery, etc.). A local presence, however, may also turn out to be essential for manufacturing firms because the size of the market share that can be conquered by exporting is typically limited. Further gains in market shares often require some form of local presence such as a subsidiary which ensures the production of products adapted to local needs and preferences. FDI activities are therefore an important indicator of international competitiveness as MNCs not only compete internationally via exports but increasingly by setting up or acquiring subsidiaries abroad.

The magnitude of EU outward FDI flows reflects the *capability* and *propensity*[2] of EU firms to internationalize their business activities. It is therefore a valuable indicator for the *corporate competitiveness,* that is, the relative productivity of firms in the EU vis-à-vis foreign competitors. On a global level, the EU emerges as the most important FDI investor, also if considering extra-EU outflows only. In 2007 extra-EU FDI reached EUR 484 billion. In comparison, FDI by US and Japanese firms amounted to EUR 229 billion and EUR 54 billion respectively (Figure 1, left). Since 2005 the EU has also been the largest

1 Important EU investors such as the United Kingdom, France, Spain and the Netherlands do not report outward foreign affiliate sales (FAS) to Eurostat yet. FAS will be available for all EU member states as of 2009.

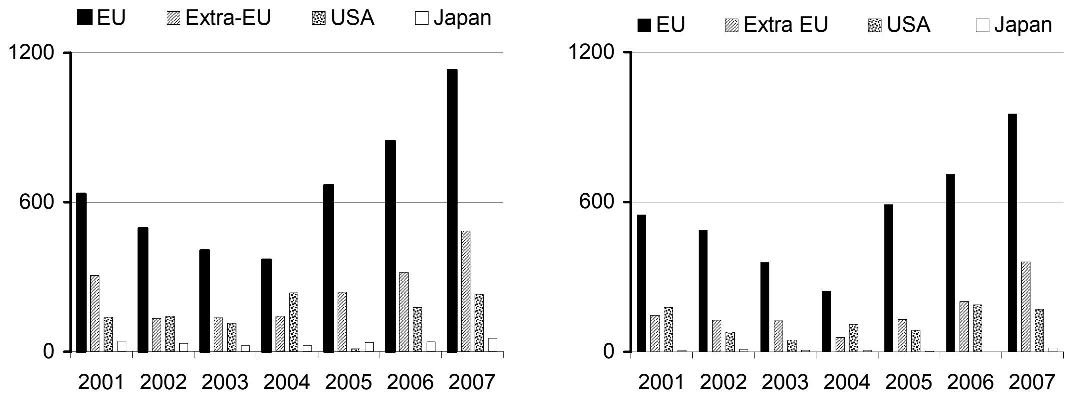
2 A firm's capacity to undertake FDI is determined by its profits, access to and cost of outside finance, the technological sophistication of its products and managerial skills. The propensity to invest means the extent to which a firm finds it advantageous to invest abroad which typically depends on the attractiveness of potential host markets (market size and growth, political risk, investment climate) but also home market factors such as the regulatory regime. The capacity to invest is closely related to ownership advantages in the terminology of Dunning (2005), whereas the propensity to invest relates to internalization advantages.

recipient of FDI, attracting EUR 360 billion from outside its territory in 2007, more than twice the amount of the inflows into the US economy (Figure 1, right).[3]

Figure 1

Outward (left) and inward (right) FDI flows of the EU, the United States and Japan

(EUR billion)



Remark: EU is EU27 for 2004-2007 and EU25 for 2001-2003.

Source: Eurostat, US Bureau of Economic Analysis.

The link between inward FDI and competitiveness is a complex issue. The presence of foreign firms in the EU market likely means some loss of market shares for domestic firms in their home market, and some companies also risk being taken over by MNCs. From a macroeconomic perspective, however, the entry of foreign firms increases average productivity in the industry concerned, thereby creating a more competitive environment. Since the competitiveness of the EU depends decisively on the *corporate* competitiveness of both domestic and foreign firms operating in the EU market, there is a positive relationship between inward FDI and the competitiveness of the EU as an economy. Moreover, inward FDI is a potential source of technology spillovers for the EU economy. In the case of new investments and extensions of existing production facilities, FDI also constitutes additional employment and investment opportunities.[4]

Chapter 2 will present the FDI relations between the EU and the BRICs based on FDI statistics, Chapter 3 will analyse company data (for methodologies see Box 1). In Chapter 4 we investigate the possible impacts of the global crisis on FDI in the BRICs, and in the final chapter we summarize our findings and draw conclusions.

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[3] If intra-EU FDI flows are included, the FDI of the EU exceeds by far those of all other countries, totalling EUR 1130 billion outflows and EUR 952 billion inflows in 2007.

[4] The impact on employment of mergers and acquisitions may be very different.

Box 1

Methodological approaches

This paper relies on two main data sources. The first one is the Eurostat Foreign Direct Investment Database (henceforth 'Eurostat') which provides consistent data on aggregate and bilateral FDI flows and stocks. Eurostat data are based on national data compiled by EU member states following balance of payments principles and international benchmark definitions of foreign direct investment. Eurostat data are used for the analysis of both inward and outward bilateral FDI relations between the EU (and also the United States and Japan) and the BRIC. Eurostat data allow for a comparison between the FDI of the EU, the United States and Japan. For the United States, data from the US Bureau of Economic Analysis are used in some instances to get more up-to-date data.

Eurostat provides a sectoral split-up of the EU's bilateral FDI with the BRICs. Unfortunately, this sectoral break-up is not available for the United States and Japan and also for the EU it is not very detailed. Moreover, there are no long time series available for sectoral data that is why this report uses only FDI stocks for the most recent year, 2006.

The second major data source tapped for this paper is 'FDI Intelligence from Financial Times Ltd' (http://www.fdimarkets.com), called the *fDi database*, which allows for the most up-to-date analysis of FDI flows possible. The information are based on press reports thus the data can be taken as investment commitments. They refer to individual investment projects by source and destination country which are then added up to countries and regions. The number of investment projects is especially important for information about services with low capital intensity which often fall out from the balance-of-payments-statistics. FDI Intelligence data differ principally and significantly from the FDI data reported in the balance of payments. While balance of payments data are published with one or two years delay and are backward looking, the fDi database is continuously updated and it is forward looking. The fDi database is incomplete concerning the amount of investments and the employment generated by FDI as this kind of data are only sporadically reported. In most cases, only the new equity investment projects enter the database, therefore the UNCTAD World Investment Report uses the fDi data for information on greenfield investments. Another feature of the database is that it operates with a different industry classification than Eurostat nomenclature, which is in many respects more detailed especially in terms of services and corporate functions. Each of the two main data sources – Eurostat and the fDi database – has its merits and shortcomings. We are confident that the parallel use of these two high quality but methodologically very distinct data sources helps to arrive at a realistic picture of FDI relations of the EU with the BRIC countries.

Sporadic reference is made to other data sources such as OECD foreign affiliate trade statistics (FATS). UNCTAD data on FDI are used to calculate the share of the EU, the USA and Japan in total inward FDI of the BRIC countries.

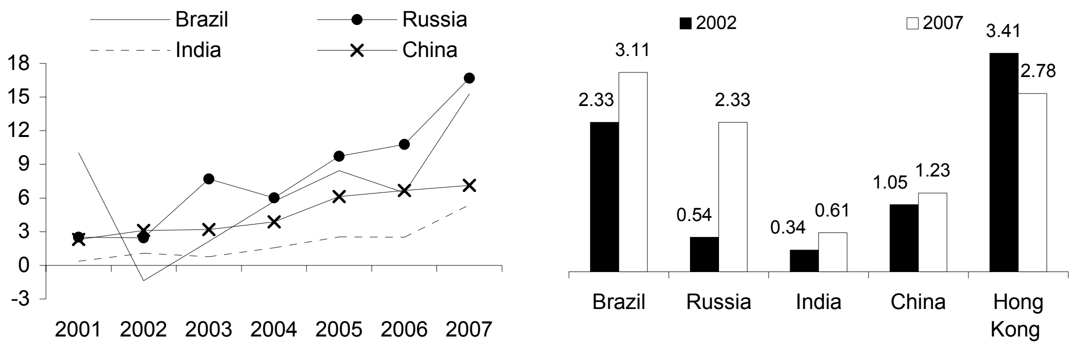
2 FDI data analysis

2.1 EU FDI in the BRICs and comparison to FDI by the United States and Japan

Bilateral investment flows document the coincidence of two ways of competitiveness: it requires *corporate* competitiveness, i.e. high relative productivity of firms on the side of the source country and *locational* competitiveness, i.e. the relative attractiveness of an economy for investors, on the side of the host country. In the case of the BRICs, large domestic markets coupled with very high growth rates over the last years and efforts – albeit in varying degrees – to improve the investment climate in their economies advanced them to the top five of the most attractive locations for FDI in recent UNCTAD surveys[5]. The EU, on the other hand, is the world's most important provider of FDI and has 55 of the 100 largest non-financial MNCs domiciled in its territory (UNCTAD, 2008b)[6], far more than any other economy. Consequently, EU FDI flows to the BRICs have increased steadily over the period 2001-2007, especially to Russia and Brazil, where flows reached EUR 16.7 billion and EUR 15.3 billion in 2007 respectively. The growth path of flows to India and China is flatter and flows remained at a low level in 2007 (Figure 2, left).

Figure 2

EU outward FDI flows to the BRICs (EUR billion) – left
Share of the BRICs in the EU's extra-EU FDI stocks (in %) – right



Remark: EU is EU27 for 2004-2007 and EU25 for 2001-2003. China excludes Hong Kong.

Source: Eurostat.

The share of the BRICs in extra-EU FDI stocks has not increased strongly in recent years, with the notable exception to Russia. Over five years, the combined share of the BRICs plus Hong Kong in extra-EU outward FDI stocks increased only by 2.5 percentage points to 10% in 2007 (Figure 2, right). Hong Kong's share in extra-EU FDI decreased between 2002 and 2007 which can be explained by the increased attractiveness of China as a destination for FDI so that the detour via Hong Kong is not necessary anymore. China's share in extra-EU stocks increased only marginally, to 1.23% in 2007, the combined share

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5 According to UNCTAD (UNCTAD, 2008a) China is perceived as the most attractive location for FDI by investors globally, followed by India. As the sole non-BRIC country among the top 5 destinations, UNCTAD lists the United States in third position, followed by Russia and Brazil which occupy rank 4 and 5 respectively. China's lead in locational competitiveness rests upon two pillars. The first is that MNCs take advantage of China's large supply of cheap labour and use China as a manufacturing platform for labour-intensive parts of production. The second is that high growth rates led to the emergence of a Chinese middle class in the order of 300 million which makes China also an attractive destination for market-seeking investment. The latter seems to gain in importance as rising wages in China's coastal regions have significantly reduced China's cost advantage in labour-intensive manufacturing (Bartlett, 2008).

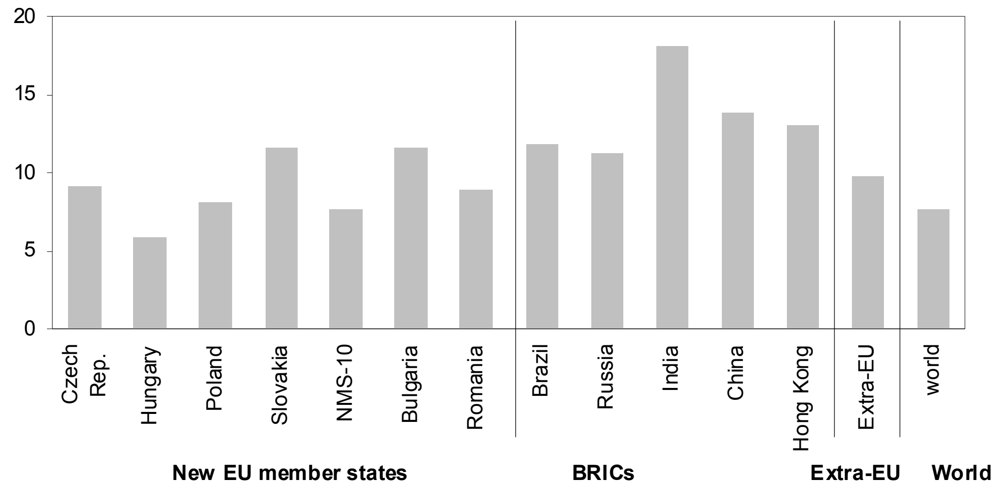
6 Ranking according to foreign assets in 2006 including assets owned by EU firms in other EU member states than their country of incorporation.

of China and Hong Kong actually declined slightly to 4% in 2007[7]. Thus one can consider this country with rapidly increasing inward investment a place where EU companies were relatively reluctant in their FDI activities.

The slow pick-up of the BRIC's share in EU outward FDI stocks is indeed surprising and it can only partially be explained by attractive investment opportunities elsewhere, such as in the close-by new EU member states. The overwhelming majority of FDI stocks continues to be in the advanced countries with high asset prices and a long history of FDI. This can change only very gradually by flows shifting to emerging economies. Other explanations for relatively low EU FDI in the BRICs can be associated with the risks and obstacles related to FDI in the individual BRIC countries.

Figure 3

Comparison of returns on FDI of EU FDI in the BRICs and new EU member states (2007)



Remark: EU is EU27. NMS10 includes Czech Republic, Hungary, Poland, Slovakia, Slovenia, Estonia, Latvia, Lithuania, Cyprus and Malta. China excludes Hong Kong. Returns on FDI in 2007 are calculated as the ratio of FDI income in 2007 to FDI stocks at the end 2006. FDI includes income on FDI equity and interest payable on inter-company debt. Income on equity consists of dividends due for payment to the direct investor, gross of withholding taxes, plus the direct investor's share of the investment company's reinvested earnings.

Source: Eurostat, wiiw calculations.

FDI is driven to some extent by returns on investments and the BRICs are very attractive in this respect (Figure 3). Taking the ratio of income earned on EU FDI abroad in 2007 to accumulated stocks until end of 2006 as a crude measure for the returns on FDI, FDI in the BRICs appear to be more profitable than FDI in the new EU member states. In 2007 EU firms earned returns on their FDI engagements above 13% in China and Hong Kong, well above the average of EU-extra FDI but also above the returns achieved in the most

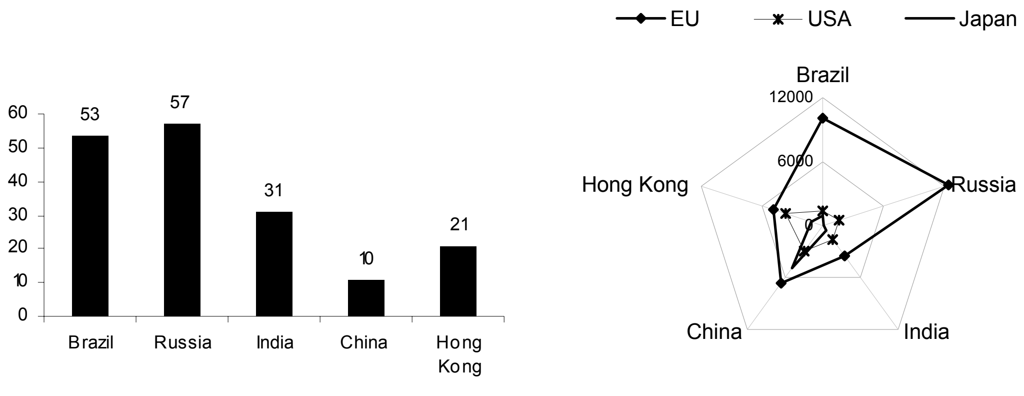
7 The same pattern is found for the US FDI stocks in China and Hong Kong, where the combined share of the two territories dropped from 3.15% to 2.71% between 2002 and 2007. The share of US stocks held in the BRICs stagnated at around 5.2% between 2002 and 2007.

profitable new member states, Bulgaria and Slovakia. Profitability of EU FDI in Russia and Brazil is somewhat lower, 11.3% and 11.8% respectively, which is similar to the returns on FDI in the most profitable new member states but well above their average[8]. With returns on FDI exceeding 18%, India emerges as the by far most profitable location among the BRICs for EU firms.

Locational factors such as the perception of country risk[9], which was found to be a decisive factor for FDI in emerging markets (Frenkel, Funke and Stadtmann, 2004), may explain the modest increase of EU FDI especially in the Asian BRICs. This would suggest that in several cases EU firms consider risk adjusted returns on FDI to be higher in the new EU member states (which also provide good investment opportunities because of privatization programmes) than in the BRICs. Other locational factors are specific to individual BRICs. For example, inefficient bureaucracy and a poorly developed infrastructure figure among the most important barriers for FDI in India (Bartlett, 2008). In China, investors' concerns about property rights and remaining restrictions and caps to foreign ownership in the service sectors restrict EU investments in banking and telecommunications. Another factor favouring FDI in the new EU member states vs. the BRICs is geographic proximity in combination with industry structure. Especially small and medium sized enterprises tend to limit their FDI engagement in geographically close countries (Hunya, 2008).

Figure 4

Share of EU FDI in the BRICs' inward FDI, average flows 2004-2007, in % – left; Comparison of FDI outflows from the EU, the USA and Japan to the BRICs, average 2005-2007, EUR million – right



Remark: EU is EU27 for 2004-2007. China excludes Hong Kong.

Source: Eurostat, UNCTAD, US Bureau of Economic Analysis.

[8] NMS10 includes the Czech Republic, Hungary, Poland, Slovakia, Slovenia, Estonia, Latvia, Lithuania, Cyprus and Malta.

[9] In Russia, for example, anxieties about the foreign investment conditions in the natural resources sectors prevail and even deepened after the dispute over the ownership structure in the Sakhalin-2 oil field project (Bartlett, 2008). In addition, FDI in sectors considered to be of strategic interest by the Russian government is restricted.

While the share of EU FDI going to the BRICs remains small, the EU is an important source of FDI for all BRICs. This constellation mirrors trade, as the EU is a more important trading partner for the BRICs than vice versa. In terms of FDI flows, the EU is by far the most important investor in Russia and Brazil accounting on average for 57% and 53% of the total FDI going to these countries in the period 2004-2007 (Figure 4, left).

In the Asian BRIC economies the share of the EU in inward FDI is much lower, ranging from 31% in India to only 10% in China. This is explained by the large intra-regional FDI flows in South and South-East Asia. In the case of China, Hong Kong stands out as the largest investor accounting for 37% of total inflows in the period 2004-2007. FDI flows originating from Singapore, Taiwan and South Korea make up another 13%[10]. The high share of intra-regional FDI in Asian countries is linked to the high degree of vertical trade integration. In the case of Hong Kong, however, a part of the FDI flows to China constitutes 'round-tripping capital', i.e. Chinese investments taking a detour via Hong Kong for tax or other reasons (Poncet, 2008). This phenomenon is also found in India and Russia. Since round-tripping inflates a country's aggregate FDI, the role of the EU as a provider of FDI to India and China might be higher than suggested by the statistics; in the case of Russia the situation is different because much of Russian round-tripping capital enters via Cyprus which is an EU member state (see Box 2). Regardless of the precise share of EU member states in Russia's inward FDI, EU firms show a very high presence in Russia. A major reason for this is Russia's proximity which is one of the major determinants of the intensity of bilateral FDI flows to emerging markets (Frenkel, Funke and Stadtmann, 2004).

The EU emerges as the largest provider of FDI among the Triad countries in each of the BRICs (Figure 4, right). In Russia and Brazil, the amount invested by EU firms equalled seven to eight times the amount of FDI undertaken by US firms in these countries (average 2005-2007). The average annual FDI flow from the EU to China in 2005-2007 amounted to EUR 6.6 billion, more than twice the amount pouring in from the United States. Japan, which has a strong Asian focus in its outward FDI, recorded on average EUR 4.9 billion to China during the same period. In Hong Kong, the magnitude of FDI flows from the EU and the United States are on a more similar level amounting to EUR 4.9 billion and EUR 3.7 billion respectively. EU flows to India were the lowest among the BRIC countries amounting to EUR 3.9 billion on average for the period 2005-2007, albeit the EU is the number one investor in India if Mauritius is neglected (see Box 2). Whereas the strong FDI links between the EU and Russia could be expected due to the proximity of the two markets and was also found in the trade in goods and services, the favourable position of EU firms in Brazil compared to US firms is more surprising and in contrast with the result found in services trade. The strong position of EU firms in the BRICs is mainly the result of

[10] The shares of Asian countries in total inward FDI of China are from Chinese sources and therefore not entirely comparable to the indicated EU share of 10% which is based on Eurostat data (see Box 2).

FDI from Spain which has close historical links with South America[11] and Germany which is a major and geographically well diversified provider of FDI.

Table 1

Major EU investor countries in the BRICs
Average annual outflow (2004-2007) and outflows in 2007 (EUR million)

	Brazil				**Russia**		
	2004-2007		**2007**		**2004-2007**		**2007**
Spain	2946	Spain	6201	Germany	2190	Germany	6699
France	1331	France	1760	Netherlands	2075	Austria	2597
Germany	1102	Germany	1146	United Kingdom	1287	United Kingdom	1958
United Kingdom	553	United Kingdom	1054	Austria	985	Belgium	1231
Belgium	502	Netherlands	559	Sweden	804	Sweden	1084
Share in EU total	*83%*			*Share in EU total*	*76%*		
	India				**China**		
	2004-2007		**2007**		**2004-2007**		**2007**
Germany	883	Germany	1721	Germany	1934	United Kingdom	1669
United Kingdom	608	United Kingdom	975	United Kingdom	972	Germany	1531
France	281	Netherlands	495	France	758	France	1433
Netherlands	276	France	366	Denmark	434	Denmark	752
Sweden	102	Sweden	192	Netherlands	395	Finland	499
Share in EU total	*86%*			*Share in EU total*	*82%*		
	Hong Kong				**BRIC (including Hong Kong)**		
	2004-2007		**2007**		**2004-2007**		**2007**
United Kingdom	3770	United Kingdom	2548	United Kingdom	7190	Germany	11813
France	650	Netherlands	1823	Germany	6684	United Kingdom	8204
Netherlands	581	France	937	Spain	3879	Spain	7150
Germany	575	Germany	716	Netherlands	3730	France	5214
Spain	567	Spain	567	France	3604	Austria	2769
Share in EU total	*94%*			*Share in EU total*	*78%*		

Remark: EU is EU27. China excludes Hong Kong. BRIC includes Hong Kong in this table.

Source: Eurostat.

A closer look at the individual EU member states' investment engagement in the BRICs and Hong Kong (Table 1) reveals that in 2007 Germany was the most important investor thanks to strong involvement in all five markets with FDI flows ranging from EUR 716 million in Hong Kong to EUR 6.7 billion in Russia. Germany figures among the top 5 investors in all BRICs and Hong Kong. FDI by France and the Netherlands to the BRICS is rather diversified by target country, whereas Spain's FDI activities are highly concentrated in Brazil. The United Kingdom, traditionally the largest investor among the EU

[11] Portugal which is the former colonial power in Brazil does not show up as a major investor in Brazil in terms of values but has several smaller MNC operating in Brazil.

member states in the BRICs with average FDI flows of EUR 7.2 billion during the period 2004-2007, has a focus on Asian, especially on Hong Kong. The United Kingdom is also among the top five EU investors in the remaining BRICs. Next to the activities of the five top EU investors mentioned, there is some important FDI from Austria, Belgium and Sweden going to Russia.

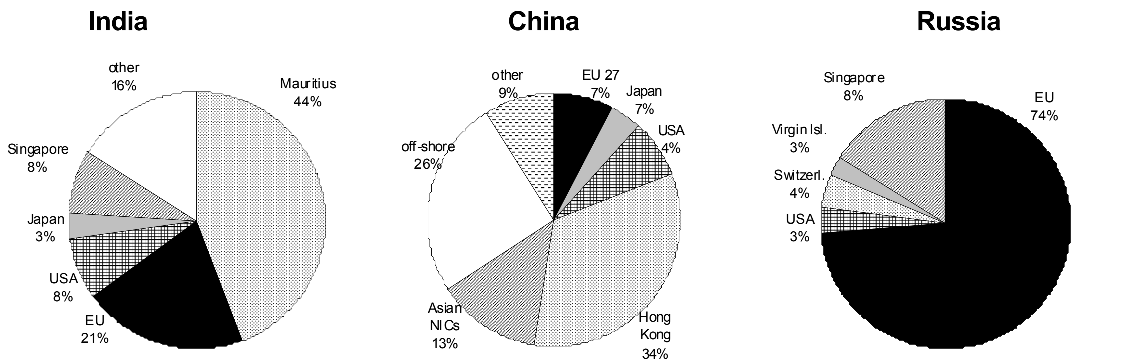
Box 2

Is Mauritius really investing more in India than the EU?

In the balance of payments FDI flows are recorded according to the principle of residence. This means that flows are allocated to the countries where the two entities that engage in a direct transaction are domiciled. This is at the origin of the possible discrepancy between the actual (ultimate) source of an FDI transaction and the source country recorded in statistics based on balance of payments principles such as Eurostat.

In the case of Russia, India and China the use of holding companies and special purpose entities (SPE) in arranging FDI transactions drives a wedge between the recorded source country of FDI and the ultimate source country. In Russia, for example, Cyprus, one of the smallest EU member states, is among the top investors according to Russia's Federal State Statistics Service. The 'Cyprus-effect' inflates the EU's share in Russian inward FDI to approximately three thirds. This is a much higher share than recorded by Eurostat because investments through some SPEs in Cyprus (in particular empty holding companies with no economic activity in Cyprus) are not covered by Eurostat. Since a part of Cypriote FDI into Russia is expected to be round-tripping capital, that is capital from Russian sources invested via the detour of Cyprus for tax or other reasons, Eurostat data better reflect the role of EU firms as FDI investors in Russia. The differences between Eurostat data and national data sources can be seen by comparing Figure 4 with the Figure below which shows the country-break down of inward FDI for India, China and Russia based on national data sources.

Inward FDI flows by main investors (average 2004-2007)



Remark: For India figures are average flows for April 2000 to November 2008 In Russian figures EU includes only United Kingdom, Cyprus, the Netherlands, Luxembourg, Germany, France. Off-shore centres include Virgin Islands, Cayman Islands, Barbados, Bahamas, Samoa. Asian NICs (Newly- industrialized countries) include Singapore, Taiwan, Korea

Source: Department of Industrial Policy & Promotion for India, China Statistical Yearbook, Rosstat for Russia.

Round-tripping capital also inflates inward FDI figures of China and India, primarily through inflows from Hong Kong and Mauritius, respectively. In the case of India, Mauritius shows up as the number one investor country accounting for 44% of the inward FDI. Different treatment of these flows can explain some of the existing differences between Eurostat data and national data sources. As in the case of round-tripping capital, the use of holding companies and SPEs domiciled in off-shore centres can make important investor countries 'disappear' in bilateral FDI statistics. For example, an US MNC might find it advantageous to use a SPE in Barbados to finance the acquisition of a Chinese firm. The acquisition of the Chinese company in this case is recorded as an Chinese inflow from Barbados. The use of holding companies and SPEs is clearly on the rise. For the US, foreign affiliates abroad classified as holding companies already accounted for 33% of the US outward stock in 2007 (Ibarra and Koncz, 2008). These problems do not appear in the fDi database of the FDI Intelligence from Financial Times Ltd which records the home country of the investor and not the financial intermediate.

2.2 Sectoral structure of EU FDI in the BRICs

Global EU outward FDI takes place predominantly in service industries accounting for more than three thirds of the EU's total outward FDI stock in 2006. The dominance of services over manufacturing is in line with the structure of the EU economy but in stark contrast to the relative importance of these two broad sectors in international trade. While the ratio between the EU's global goods exports and services exports stands at over 3 (3.3 in 2007), the ratio between FDI flows in goods producing sectors[12] to FDI flows in services sectors is just over one third. (0.36 in 2006). So the relative importance of goods and services are precisely reversed in the context of FDI when compared to trade.

The EU's FDI stocks in the BRICs are skewed to the service sector as well, but the manufacturing sector occupies a much larger share relative to global and extra-EU FDI stocks. In India and China manufacturing and service industries both account for approximately half of the total stock (Table 2). In the case of India and China the relatively high share of manufacturing can to some extent be explained by restrictions to FDI, including limitations of foreign ownership in industries considered as 'strategic', which are more severe in services industries and infrastructure such as electricity, transport and telecommunication (Koyama and Golub, 2006). The sectoral composition of EU FDI stocks in Brazil resembles very much the structure of FDI in industrialized economies with roughly two thirds attributable to services. Investments in the primary sector only play a marginal role in Brazil, India and China. In Russia, the large FDI stock in the primary sector which includes exploration of oil and gas stands out. It represents 18% of the EU's FDI stock in Russia, leaving 30% to manufacturing and 50% to services. The significance of the primary sector in inward FDI in Russia, however, is expected to have declined after the adoption of the new law on 'strategic sectors' in April 2008. In Hong Kong, the situation is very different from China and the other BRICs. Basically the entire FDI stock, amounting to EUR 86 billion, owned by EU firms is attributed to the service sector.

[12] Goods producing sectors include agriculture and fishing, mining and quarrying, manufacturing and electricity, gas and water.

Table 2

EU outward stocks in the BRICs by economic activity (2006), in EUR million

	Brazil	Russia	India	China	Hong Kong
Agriculture and fishing	**36**	**23**	**2**	**5**	**1**
Mining and quarrying	**714**	**9268**	**376**	**1223**	**121**
Manufacturing	**21898**	**15376**	**5901**	**15214**	**2447**
Food products	4307	2682	1177	825	109
Textiles and wearing apparel	409	45	37	194	84
Wood, publishing and printing	299	916	177	483	39
Refined petroleum products and other treatments	652	7777	632	384	220
Manufacture of chemicals and chemicals products	2986	823	1120	2796	182
Rubber and plastic products	1004	509	107	696	153
Metal products	4234	344	210	975	141
Mechanical products	1591	236	807	2169	1055
Office machinery and computers	13	-5	35	108	77
Radio, television, communication equipments	360	89	208	1166	13
Vehicles and other transport equipment	4406	825	573	2973	146
Electricity, gas and water	**863**	**270**	**146**	**278**	**10**
Construction	**386**	**380**	**22**	**55**	**97**
Services	**52877**	**24492**	**5559**	**14797**	**83333**
Trade and repairs	2015	2867	356	1958	2551
Hotels and restaurants	216	357	251	18	61
Transport and storage	1254	89	294	577	109
Telecommunications	205	913	88	28	1285
Post and courier activities	148	53	77	6	-402
Financial intermediation	26572	12664	3413	6771	72345
Real estate and business activities	21908	7164	1026	5363	7209
Real estate	*241*	*312*	*8*	*167*	*91*
Renting of machinery and equipment	*92*	*76*	*1*	*15*	*4836*
Computer activities	*195*	*146*	*323*	*123*	*143*
Research and development	*381*	*8*	*18*	*313*	*3*
Other business activities	*20997*	*6621*	*677*	*4742*	*2134*
Total	**78330**	**50226**	**12308**	**32329**	**86401**

Remark: EU is EU27. China excludes Hong Kong. Economic activities according to Eurostat nomenclature. Numbers do not add up to Total because of non-allocated activities.. FDI outward stocks are classified according to the activities of the non-resident enterprise, i.e. the enterprise in the respective BRIC country.

Source: Eurostat.

Financial intermediation is the most important FDI activity for EU firms in the BRICs with its share ranging from approximately 20% in China to one third in Brazil (Table 2). In Brazil and in Russia, where financial intermediation accounted for 25% of total stocks in 2006, the dominant position of the financial sector is the result of the internationalization of European banks, also in retail banking[13]. EU banks are less dominant in the banking sectors of India and China, mainly because of ownership restrictions in these countries. Financial intermediation is nevertheless the leading industry in these countries mostly due to the wholesale financial sector and the emergence of new financial centres such as Shanghai or Mumbai. In Hong Kong essentially all FDI activities of EU firms is in financial services reflecting Hong Kong's role as a global financial centre.

Real estate & business activities and trade & repairs follow financial services in terms of EU FDI stocks in all BRICs. This may be less the result of similar strategies of EU MNCs or similarities of economic structures on the side of the BRICs than the low level of disaggregation of data in the category of business services, albeit in the case of India the focus on computer activities stands out.

There is more variation within the manufacturing sector. Similar patterns across BRICs, however, also exist in manufacturing not only because capital-intensive industries usually get more FDI than others, but also due to the competitive advantages of EU firms. The section on trade revealed a huge positive specialization of the EU on machinery and equipment and other transport equipment in bilateral exports to the BRICs reflecting the EU's comparative advantages. Therefore machinery and equipment[14] and transport equipment are also found among the top five industries in each of the BRICs in terms of FDI stocks in 2006 (with the exception of machinery and equipment in Russia.) The same is true for the chemical industry, another stronghold of EU firms and globally the most important sector for the EU in terms of FDI.

Reflecting the match of some large EU MNCs and a large and growing market size, the food industry is among the top five manufacturing industries in Brazil, Russia and India. In the latter the EU food industry has even accumulated the largest FDI stocks within manufacturing. In Russia, the FDI stocks owned by EU firms also reveal the high dependency of Russia on its natural resources. Natural resources, comprising mining and quarrying – which in turn includes oil and gas exploration – and refined petroleum account

[13] In the case of banks, the set-up or acquisition of an affiliate bank abroad generally induces large FDI flows since inter-company loans are recorded as FDI. This means that all loans provided by EU parent banks to their foreign affiliates are recorded as FDI and add to the EU's FDI stock abroad. Although this is also the case for all other enterprises, loans between affiliated banks are of a much higher magnitude because typically foreign affiliates have their parent banks as an important refinancing source for their entire banking operations.

[14] Machinery and equipment (NACE division 29) is the equivalent to mechanical products (2900) which is the terminology used in the Eurostat nomenclature for FDI.

for EUR 17 billion or one third of the total EU FDI stocks in Russia[15]. The major role of petroleum in EU-Russia relations is also highlighted by the fact that 8% of the global EU FDI stock in refined petroleum is located in Russia (2006).

Box 3

Holding companies, SPEs and the industry distribution of FDI

Some caution is warranted when interpreting data on FDI stocks by industry. Much like in the case of the geographical split-up of FDI, the structuring of FDI transaction can drive a wedge between the actual industry in which a firm undertakes FDI and the industry under which the transaction is recorded. In line with international guidelines (IMF, Balance of Payments Manual), the allocation of an FDI transaction to a specific economic activity is made on the basis of the direct transaction, not the entity that is ultimately acquired. The complex company structures of MNCs and the possibility to create 'empty holding companies' or special purpose entities (SPEs) can easily blur the relative importance of industries for both inward and outward EU stocks as reported by Eurostat.

In the case of EU inward FDI stocks the FDI transactions undertaken by enterprises from the BRICs are recorded according to the activity of the *direct investment enterprise*, i.e. the EU entity which is acquired or established. In case such a transaction, for example the acquisition of an EU manufacturing company by a Russian enterprise, is made via an SPE in Luxembourg, it would be recorded under 'financial intermediation' unless the reporting authority can group the SPE to the investor company.

Likewise, the EU's outward FDI stocks are allocated according to the economic activity of the acquired company (direct investment enterprise), i.e. the enterprise located in the BRICs. Structuring the transaction via an SPE or a holding company may obscure the economic activity the FDI transaction is really related to, i.e. the industry in which the acquired company ultimately operates.

Finally, complex company structures 'create' significant and increasing amounts of FDI that neither relate to mergers or acquisitions nor to a new project (greenfield investment). All cross-border transactions that entail a change in ownership between affiliated companies are equally recorded as FDI. In case of EU inward FDI, if the direct investment enterprise is a financial holding, this kind of transaction is recorded under financial intermediation. If the direct investment enterprise is a holding company providing management functions, this transaction is recorded under 'other business activities'.

The bottom line is that FDI data by sectors and industries may be biased towards services (financial intermediation and business activities) because of the underlying methodology for allocating transactions and stocks to industries. The relatively bigger importance of manufacturing in the FDI relations between the BRICs and the EU found in the analysis of investment projects (see below) also point in this direction. The fDi database does not have the bias of the balance of payments statistics, although its reliability is weakened by relying on incomplete information provided by companies.

[15] The large share of FDI related to natural resources in the EU' FDI outward stock in Russia mainly reflects 2-3 large projects by leading EU petroleum companies.

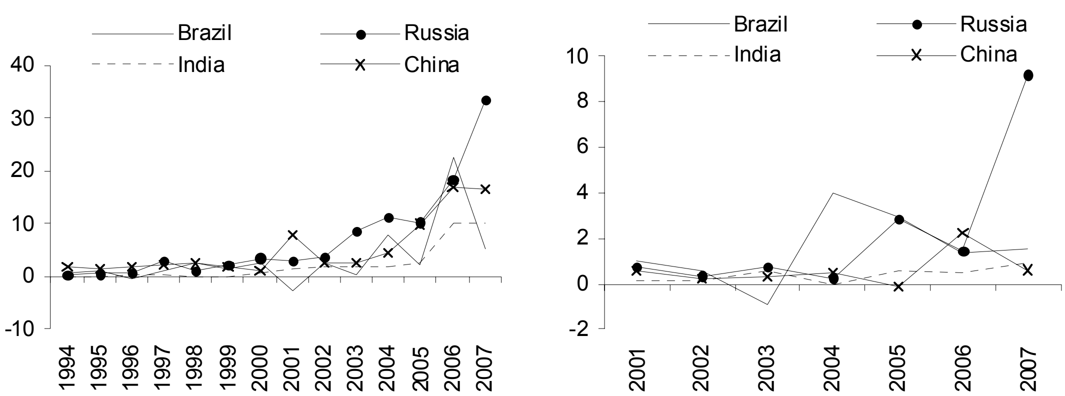
2.3 FDI of the BRICs in the EU in comparison to the United States and Japan

Outward foreign direct investment undertaken by MNCs of emerging markets including the BRICs is a rather new phenomenon. FDI outflows from the BRICs picked up in the early 1990s and its growth accelerated markedly only with the beginning of the new millennium (Figure 5, left). This gives all of the BRICs, excluding Hong Kong, a latecomer status with regards to outward FDI. Rapid growth of outward FDI flows since the beginning of the decade has made Russia the most important FDI investor among the BRIC countries in 2007. Brazilian global outward FDI is rather volatile but shows a clear positive trend and a strong pick-up is observable for China and India. Much less of an upward trend is discernible in the FDI flows of the BRICs directed towards the EU, with the important exception of Russia (Figure 5, right). Rather than a steady upward trend, the EU inflows originating from Brazil, India and China show single peaks in different years such as Brazil with EUR 4 billion in 2004. Russian FDI flows to the EU, amounting to EUR 9 billion in 2007, constituted the largest inflow recorded from any of the BRICs during the period 2001-2007. Hong Kong used to be an active FDI investor in the markets of the EU but has lost this position due to disinvestments over the last three years.

Figure 5

BRICs' global FDI outward flows (left) and bilateral flows to the EU (right)

(in EUR billion)



Remark: EU is EU27 for 2004-2007 and EU25 for 2001-2003. China excludes Hong Kong.

Source: UNCTAD, Eurostat.

The BRICs are not a major source of FDI for the EU. Flows from the BRICs and Hong Kong taken together, on average, accounted for only 5.5% of extra-EU inward FDI flows during the period 2002-2007. Moreover, their share is not really increasing, mainly because of falling flows from Hong Kong[16]. This makes the BRIC countries underrepresented in the EU market in terms of FDI flows when compared to their share in global FDI which stood at

[16] FDI flows from the BRICs, excluding Hong Kong, accounted for 3.5% of extra-EU inflows into the EU over the 2002-2007 period. But even their share show no clear upward trend. The significance of the BRICs as an investor for the EU is even smaller when stocks are considered because of the late start of any sizeable outward FDI by the BRIC countries.

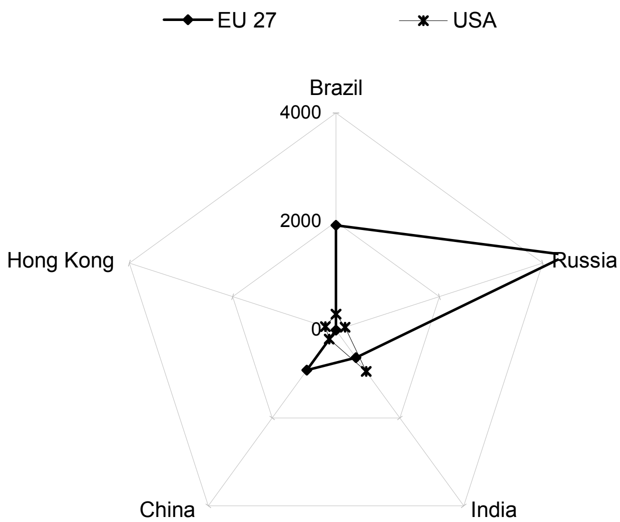
7.1% in 2007. The same is true for inflows received by the US from the BRICs. BRIC FDI flows including those from Hong Kong as recorded by the United States started from insignificant levels in 2002 (0.11% of total US FDI inflows), reached a peak of 2.8% in 2005 due to a mixture of very low total US inflows and an increase of FDI received from the BRICs, but declined again to 0.58% of total inflows in 2007.

The comparison between FDI inflows to the EU and the United States originating from the BRICs shows that Russia and Brazil invested on average much larger amounts in the EU than in the United States during the period 2005-2007 (Figure 6). The same is true for China but not for Hong Kong because of Hong Kong's disinvestments in the EU in recent years. Finally, FDI flows suggest that Indian investors have a preference for the United States which received on average EUR 945 million annually in the period 2005-2007. This represents the highest inflow from any of the BRIC countries to the United States, whereas Indian average annual flows to the EU were only EUR 628 million during the same period, the least among all of the BRICs.

Figure 6

Comparison of FDI inflows from the BRICs into the EU and the USA

(average flows 2005-2007) in EUR million



Remark: EU is EU27. China excludes Hong Kong.

Source: Eurostat, US Bureau of Economic Analysis.

Recalling the three major objectives for firms to undertake FDI distinguished by FDI theory, i.e. market seeking investment, resource-seeking investment and efficiency-seeking investment (UNCTAD, 1998) gives a first hint on why the EU is of rather low priority in the BRICs' outward FDI activities. First of all, resource-seeking FDI which aims at securing needed raw materials and other natural resources is a major investment motive for the

BRICs, in particular for China and India. In volume terms China's outward FDI is dominated by state-controlled enterprises in natural resources or telecommunication most of which enjoy a monopoly or monopoly-like situation in the Chinese economy (Morck et al., 2008). Obviously, resource-seeking type of FDI by the BRICs is directed predominantly to resource-rich countries of Africa, South America and Asia and not to the EU. Secondly, no significant efficiency-seeking FDI can be expected to pour into the EU from the BRICs as labour-costs are generally much higher in the EU than in the BRICs[17]. This means that access to new markets remains as the major motive, supplemented by additional motives such as access to new technologies[18] (Holtbrügge and Kreppel, 2008). In the case of Russia the geographical diversification of investment also appears as an investment motive (Deutsche Bank, 2008).

Outward FDI activities of the BRICs have a strong regional focus. Especially in Asia a lot of so-called 'South-South' investment, meaning FDI between developing or emerging markets, is taking place. The same applies to Brazil which is a big investor in South America, and Russia which is an important investor in the Commonwealth of Independent States (CIS). The major reason for this pattern is the role of geographical distance which, as mentioned earlier, is an important determinant of bilateral FDI flows. Hence – as is the case for most MNC in the EU, the US and Japan – many firms from the BRICs start their internationalization strategies in neighbouring countries where culture and the legal and administrative environment are more similar. The Russian telecom provider Vimpelkom which has nation-wide licences in a series of CIS-countries such as Kazakhstan, Tajikistan, Ukraine, Uzbekistan, Georgia and Armenia but is not present in the EU can serve as examples in this respect. In some instances the regional focus may also be grounded by the lack of competitiveness, i.e. of the capability to successfully enter the highly competitive markets of developed countries.

Finally, FDI flows from the BRICs to the EU may also be hampered by restrictions to FDI on the side of the EU. Albeit the EU in general appears to be very open towards inward FDI according to OECD's FDI regulatory restrictiveness index (Golub, 2003; Koyama and Golub, 2006), restrictions do exist, mainly in infrastructure sectors such as electricity, transport and telecommunications but also in finance. According to the OECD index, in EU member states (and other OECD countries, including the United States and Japan) the predominant form of restrictions is screening and approval procedures. In contrast, most EU member states maintain hardly any formal limitations to foreign ownership. A

[17] In general, efficiency-seeking is not the major motive for outward FDI by the BRICs but there is anecdotic evidence for such investments. For example, Chinese companies have started to transfer the production of some of its low-tech manufacturing products to countries with lower wages such as the offshoring to Indonesia of the production of DVDs (Sauvant, 2005).

[18] FDI motivated by the access to new technologies or the acquisition of an existing brand name is often subsumed under resource- and asset-seeking FDI. Assets in this context refer to values created by firms in contrast to raw materials or natural resources.

shortcoming of the OECD index is that it mainly captures overt restrictions but miss informal and tacit forms of restrictions such as procedural delays or lack of transparency on the award procedure in public tenders. National resentments and anxieties against foreign investors as, for instance, those of the activities of sovereign wealth funds (SWF)[19] in the EU increase the possibility of informal ways of discrimination against unwanted foreign direct investors. Moreover, several EU member states including Germany, the United Kingdom and France have legal frameworks that enable them to block FDI projects in sectors deemed as strategic for national safety or security reasons. The same, however, also applies to the United States and Japan (UNCTAD, 2008b).

2.4 Sectoral structure of BRICs FDI in the EU

The late start of outward FDI undertaken by MNCs from the BRICs and the mediocre priority given to the EU as a target country means that as of 2006 stocks owned by BRICs firms in the EU are modest. Accumulated stocks of Brazil and Russia, both equal to approximately EUR 15 billion each, are much larger than those of China and India which amount to EUR 3.6 billion and EUR 2.2 billion, respectively. All BRICs have in common that their outward FDI in the EU is highly concentrated in the service sector (Table 3).

Hong Kong's outward FDI stock in the EU is mainly in telecommunications. This is explained by the activities of Hutchison Whampoa, the largest MNC in emerging markets in terms of foreign assets (UNCTAD, 2008b) which, within the EU, is active in Austria, Denmark, Ireland, Italy, Sweden and the United Kingdom. In the case of Brazil, Russia and India industries related to business activities have accumulated the largest outward FDI stocks in the EU as of 2006 (Table 3).

For India the dominant role of business activities in outward FDI towards the EU is to some extent the result of the increasing internationalization of the Indian IT and software cluster, led by firms such as Tata Infotech and Infosys Technologies. Computer services account for EUR 286 million or 39% of the EUR 741 million FDI stocks in real estate and business activities owned by Indian firms. In Brazil also a sizeable number of IT and software development firms (such as Itautec) have emerged and started to go abroad (Gouvea, 2007) but the FDI stock owned in the EU in business activities are predominantly the result of Brazilian business and management consultancy firms that – within the EU – concentrate their activities in Spain[20]. The second most important service industry for Brazil, Russia and India in bilateral FDI relations with the EU is financial intermediation. In the case of Russia, a part of the FDI stock owned in the EU can be attributed to the activities of Vneshtorgbank (VTB), the second largest bank in the country. VTB's has

19 Russia (Stabilization Fund and National Welfare Fund), China (China Investment Corporation) and Hong Kong (Hong Kong Monetary Authority Exchange Fund) all have significant SWFs.

20 Business and consultancy services include activities of holding companies with active management functions.

wholly owned subsidiaries in Austria, Cyprus and subsidiaries (majority-owned) in France, Germany and the United Kingdom. The internationalization strategy of VTB in the EU is to follow CIS companies on the European market. For China, financial intermediation is by a wide margin the dominant industry in terms of outward stocks in the EU as of 2006. This can partly be attributed to the fact that major banks such as Commercial Bank of China, Bank of China, China Construction Bank, Bank of Communications all have established branches or representative offices in several EU member states[21].

Table 3

EU inward stocks owned by the BRICs by economic activity (2006), in EUR million

	Brazil	Russia	India	China	Hong Kong
Agriculture and fishing	**2**	**4**	**-1**	**1**	**-7**
Mining and quarrying	**12**	**-5**	**6**	**5**	**17**
Manufacturing	**344**	**540**	**590**	**420**	**340**
Food products	212	31	408	31	-17
Textiles and wearing apparel	5	3	-2	19	69
Wood, publishing and printing	2	41	-1	24	46
Refined petroleum products and other treatments	1	3	9	0	29
Manufacture of chemicals and chemicals products	20	80	120	6	-122
Rubber and plastic products	7	12	-7	32	-35
Metal products	29	135	14	13	5
Mechanical products	108	23	12	27	94
Office machinery and computers	-58	13	1	236	44
Radio, television, communication equipments	6	109	3	8	97
Vehicles and other transport equipment	3	69	29	19	-6
Electricity, gas and water	**2**	**903**	**-2**	**1**	**-6**
Construction	**85**	**289**	**-3**	**13**	**2**
Total services	**14168**	**12143**	**1463**	**3101**	**16317**
Trade and repairs	1939	1122	150	312	352
Hotels and restaurants	5	43	1	5	38
Transport and storage	48	116	10	98	284
Telecommunications	8	18	28	24	10283
Post and courier activities	6	4	-21	2	599
Financial intermediation	4004	3921	523	2452	2301
Real estate and business activities	8130	6368	741	197	2386
Real estate	*105*	*559*	*15*	*42*	*377*
Renting of machinery and equipment	*8*	*20*	*8*	*21*	*26*
Computer activities	*8*	*-3*	*286*	*3*	*99*
Research and development	*2*	*1*	*-2*	*-18*	*-6*
Other business activities	*8006*	*5789*	*435*	*150*	*1888*
Total	**14625**	**14571**	**2222**	**3566**	**17461**

Remark: EU is EU27. China excludes Hong Kong. Economic activities according to Eurostat nomenclature. Numbers do not add up to Total because of non-allocated activities.. FDI inward stocks are classified according to the activities of the resident enterprise, i.e. the EU enterprise.

Source: Eurostat. EU is EU27.

21 The importance of the financial sector in the BRIC's outward FDI activities in the EU is nevertheless surprising. Part of the explanation may be the bias towards services in the recording of FDI stocks (see Box 3).

There is very little outward FDI undertaken by BRIC manufacturing firms with the exception of India. In several cases, the existing stocks match well with a documented single transaction. For example, the food industry is the most important manufacturing sector in the Indian FDI stocks in the EU (EUR 408 million) due to the takeover of a British tea company (Tetley Tea) by Indian Tata Tea in 2000 (Sauvant, 2005). The growing Indian pharmaceutical industry, which is a major player in producing generic drugs, expanded into the EU via the acquisition of RPG Aventis in France by Ranbaxy Technologies. In case of China most manufacturing FDI in the EU is in the computer industry which matches well with the activities of the Chinese top notch computer manufacturer Lenovo. The company has, for instance, established a production facility in Poland.[22]

Russian manufacturing outward FDI in the EU is very limited. The Russian investment activities in electricity, gas and water, with Gazprom being the main investing company, led to the accumulation of EU inward stocks from Russia of EUR 900 million which easily exceeds the FDI stocks accumulated in all manufacturing industries.

2.5 FDI and competitive positions

A local presence of firms from the BRICs in the EU market is still more the exception than the rule. Despite single examples, overall, MNCs from the BRICs exert only very limited competitive pressure via subsidiaries established in the EU and competition is much fiercer via the trade channel. For the manufacturing sector this can be seen by comparing the manufacturing sales of foreign affiliates of BRIC MNCs in the EU member states, as recorded by the OECD Foreign Affiliates Trade Statistics (FATS), with the imports of goods from the BRICs into the EU. In many EU member states, the sales of BRIC foreign affiliates in their domestic market are reported to be zero[23]. In all cases where positive foreign affiliate sales (FAS) of BRIC firms are recorded such as Indian (EUR 360 million) and Chinese affiliates' sales (EUR 751 million) in France, Indian affiliates' sales in the United Kingdom (EUR 316 million) or Russian affiliates' sales in Italy (EUR 481 million), these amounts are minuscule in comparison with the imports of these EU member states from the respective BRIC country (Figure 7). This suggests that in manufacturing, companies from the BRICs rely largely on exports in the competition for market shares in the EU and hardly compete via affiliates established there. The almost complete absence of foreign affiliates of the BRICs in the EU market can be seen as a competitive advantage for EU manufacturing firms in their home market. At the same time, however, this also

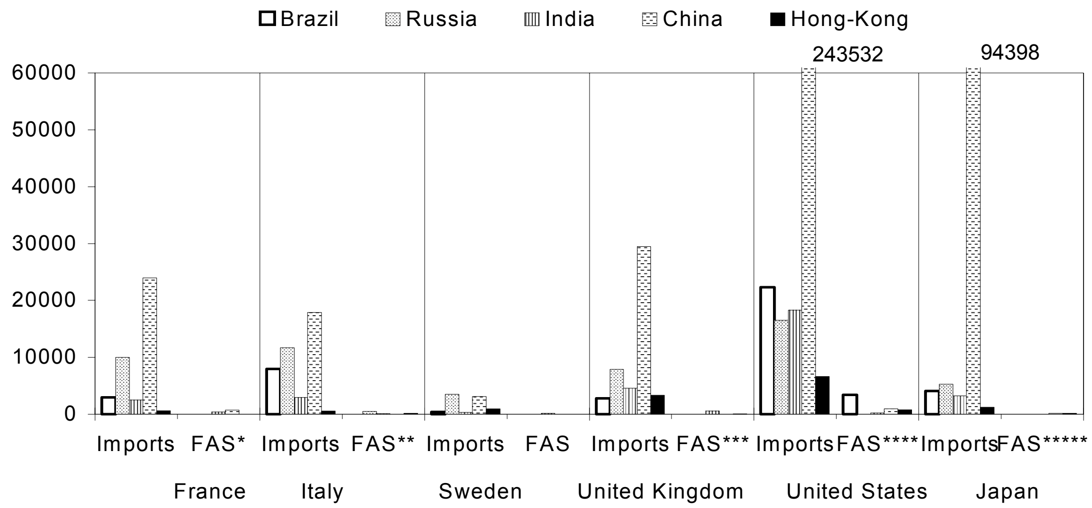
[22] Lenovo has expressed interest in the takeover of the Siemens shares in the Fujitsu Siemens Computer joint venture (EE Times Europe, 2008). This intention is of course not reflected in Eurostat data.

[23] Information of sales of foreign affiliates is not yet obtainable for all EU member states. Member states such as Germany, Spain or the Netherlands do not provide this kind of information. It is therefore not possible to arrive at an EU aggregate.

means that the BRICs' FDI activities hardly create any additional employment opportunities in the EU. The same is true for BRICs' MNCs on the Japanese and the US markets.

Figure 7

Goods imports from the BRICs and sales of BRICs' foreign affiliates in manufacturing in the respective economy (2006), EUR million



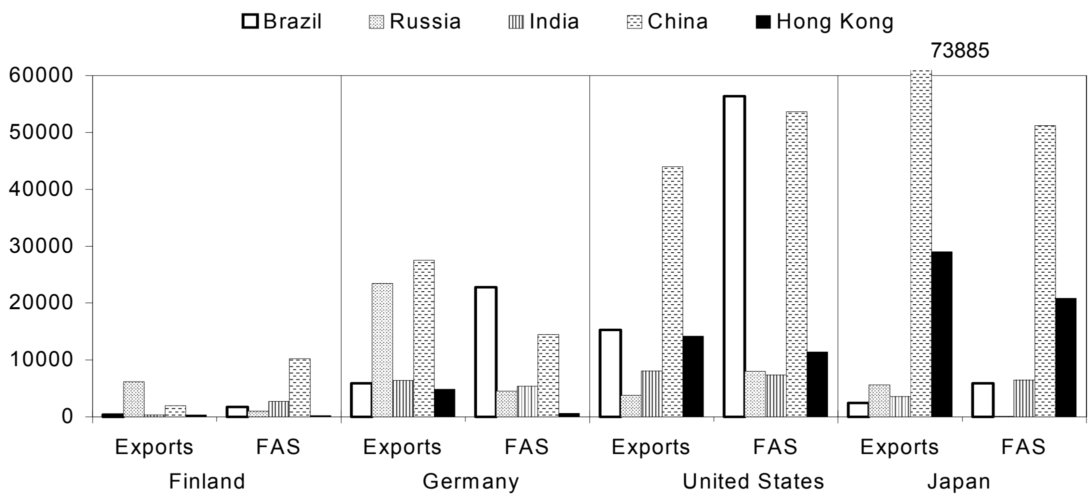
Remark: China excludes Hong Kong. Companies are considered as foreign affiliates if a foreign firm holds majority ownership.

* value for Russia 2005. ** values are 2005. *** values 2005 except for India. **** value for China 2005. ***** value for India 2005.

Source: UN Comtrade, OECD Foreign Affiliate Trade Statistics.

Figure 8

Goods exports to the BRICs and sales of foreign affiliates in manufacturing of the respective country in the BRICs (2006), EUR million



Remark: China excludes Hong Kong. Companies are considered as foreign affiliates if a foreign firm holds majority ownership.
Source: UN Comtrade, OECD Foreign Affiliates Trade Statistics.

In contrast, EU FDI in the BRICs has led to a strong local presence of EU firms in these markets and EU firms seem to compete intensively via the sales of affiliates in the markets of the BRICs. Comparing FAS of EU MNCs in the BRICs with EU exports to these markets shows that in several instances FDI has become the primary mode of entry and channel of competition for EU firms. Sales of German affiliates in Brazil, for example, exceed by far the volume of German merchandise exports to Brazil, and the same is true for Finish FAS in China (Figure 8). FAS play an extremely important role for US MNCs as well, particularly in Brazil and China. For Japanese firms exports to and sales of Japanese affiliates in China, Hong Kong and India are both important. In China and Hong Kong exports still exceed FAS but the reverse is already true in Japan's trade and investment relations with India.

3 Investment project database analysis

This section is based on the *fDi database* which covers overseas investment projects recorded by between 2003 and 2008. First we look at the FDI of the world in the BRICs (Brazil, Russia, India, China and Hong Kong), than at the investments of the EU15 in these countries. Compilation of data for other EU members failed due to methodological problems, but it is quite sure that the overwhelming majority of EU27-related projects are covered. (For detailed methodological notes see Box 1.)

Table 4

Investment projects in the BRICs, by year

Year	Total no. of projects	FDI EUR mn	From EU, projects	EU in total projects %	From EU, FDI EUR mn	EU in total FDI %
2003	2,582	122,129	828	32.1	40,917	33.5
2004	3,010	107,687	937	31.1	30,127	28.0
2005	2,642	64,279	905	34.3	21,489	33.3
2006	3,089	107,491	1110	35.9	38,161	35.5
2007	2,546	92,525	1016	39.9	30,163	32.6
2008	3,449	97,527	1311	38.0	38,879	39.9
Total	17,318	591,638	6,107	35.3	199,736	33.8

Source: FDI Intelligence from Financial Times Ltd.

3.1 Global and EU15 investments in the BRICs resilient to global crisis until 2008

The BRICs received more than 17.5 thousand FDI projects in the past six years out of a world-total of 73.6 thousand projects registered in the fDi database (Table 4). The highest number of projects was recorded in 2008; this was also the year with the most significant increase compared to the previous. As to the amount of investment in reporting projects, the total was EUR 592 billion over six years. The highest amount was achieved in 2003, highest growth in 2006. Annual fluctuations like the setback in 2005 followed global trends. But the expansion of FDI in the BRICs in 2008 was against the world-wide trend. The impacts of the crisis came to these countries with some delay and less intense than to other parts of the world. The BRICs may have attracted investors in search of still expanding markets.

Table 5a

Investment projects in the BRICs, by source country

Source country	2003	2004	2005	2006	2007	2008	2009	Total
USA	705	882	843	957	732	926	41	5,086
Japan	366	487	281	273	194	332	12	1,945
Germany	212	216	224	259	242	289	13	1,455
UK	145	202	170	259	201	259	22	1,258
France	117	135	133	183	161	227	10	966
Italy	66	85	80	77	71	108	6	493
South Korea	80	90	83	84	69	83	3	492
Taiwan	88	70	43	78	62	64		405
Netherlands	65	66	46	63	68	90	1	399
Hong Kong	85	50	46	65	62	81	6	395

Source: FDI Intelligence from Financial Times Ltd.

Table 5b

EU investment projects in the BRICs, by source country

Source country	2003	2004	2005	2006	2007	2008	2009	Total
Germany	212	216	224	259	242	289	13	1,455
UK	145	202	170	259	201	259	22	1,258
France	117	135	133	183	161	227	10	966
Italy	66	85	80	77	71	108	6	493
Netherlands	65	66	46	63	68	90	1	399
Sweden	51	57	67	64	44	57	3	343
Finland	43	28	70	67	64	48	2	322
Spain	26	37	21	29	51	90	7	261
Austria	15	32	26	41	36	35	3	188
Belgium	19	29	24	29	33	42	4	180
Denmark	32	26	27	21	21	30		157
Portugal	20	17	3	3	6	15		64
Luxembourg	5	4	6	8	8	6		37
Ireland	4	2	7	3	4	11		31
Greece	8	1	1	4	6	4	1	25
EU Total	**828**	**937**	**905**	**1,11**	**1,016**	**1,311**	**72**	**6,179**

Source: FDI Intelligence from Financial Times Ltd.

3.2 Major investors in the BRICs: role of EU increasing

The major source of FDI in the BRICs is by a large distance the US with more than 5 thousand investment projects, 29% of the total (Table 5). The highest number of investments occurred in 2006 followed by 2008. Last year the share of US projects was lower than before while that of Japan, second in the overall ranking, increased. The main EU investors, Germany, the UK, France and Italy occupy the ranks 3 to 6, with Germany coming close to Japan. The joint share of the four largest EU economies amounts to 24% for the whole observed period and 26% in 2008 which is a slight increase in concentration. The share of the EU15 increased from 32% in 2003 to 38% in 2008 which points to a growing importance of the EU among the investors in the BRICs.

In terms of reported investment capital the lead of the USA is much smaller than for the number of projects, with 15% for the whole observed period and only slightly higher in 2008. Germany comes second while Japan is further down the list. Investing countries with relatively high amounts of investments relative to the number of projects include Korea and Hong Kong. Those with relatively small sums per project are France and Italy. Still, the share of the four leading EU investors is 22%, higher than that of the USA for the whole observed period, reaching as much as 27% in the year 2008. As to the EU15, their share in the invested sum increased from 33% in 2003 to 40% in 2008. This is another strong argument supporting the increasing role of the EU investors in the BRICs.

3.3 Most foreign projects in China, for the EU also Russia and India important

Almost half of the FDI projects realized in the BRICs went to China, together with Hong Kong 54.5% of the total (Table 6). The second target was India with half as many projects as China, than again with great distance Russia and finally Brazil. 2008 was the peak year for all the countries and 2007 was the weakest year. As all BRIC destinations and all major investing countries show the same fluctuation in the number of projects over time, the fluctuations must have to do with general and not country specific processes.

Table 6a

Investment projects in individual BRICs

Destination country	2003	2004	2005	2006	2007	2008	2009	Total
China	1,323	1,545	1,244	1,402	1,190	1,483	64	8,251
India	452	694	590	983	690	958	56	4,423
Russia	427	383	513	397	368	561	24	2,673
Brazil	289	261	170	149	152	245	13	1,279
Hong Kong	91	127	125	158	146	202	11	860
Total	2,582	3,010	2,642	3,089	2,546	3,449	168	17,486

Source: FDI Intelligence from Financial Times Ltd.

Table 6b

EU15 investment projects in individual BRICs

Destination country	2003	2004	2005	2006	2007	2008	2009	Total
China	298	367	371	435	427	481	19	2,398
India	139	202	160	346	264	358	28	1,497
Russia	216	217	270	212	211	303	17	1,446
Brazil	140	115	66	57	58	107	5	548
Hong Kong	35	36	38	60	56	62	3	290
Overall Total	**828**	**937**	**905**	**1,11**	**1,016**	**1,311**	**72**	**6,179**

Source: FDI Intelligence from Financial Times Ltd.

As to the amount of invested capital, the lead of China is smaller than in terms of the number of projects, and the investments in Hong Kong is of very small size. Russia has received the second largest amount of FDI. The relatively large size of investments in Russia can be linked to the capital-intensive oil and gas sector. Low capital intensity in Hong Kong and in India is a characteristics of the services sectors.

European investment projects in the BRICs differ from the global first of all because EU15 countries invest relatively less in China and more in Russia than the rest of the world. China is the most important destination for EU investors but they give only 29% of the projects and 25% of the invested capital in that country in 2003-2008. But the EU share has been on the rise and in 2008 almost 35% of the projects in China came from the EU15. The picture we get on EU FDI in China from the *fDi database* largely differs of what we get from the Eurostat statistics. This may have primarily methodological reasons.

For Russia, the EU is more important than for China: more than half of the projects and 40% of the invested capital came from the EU and the trend is increasing. India is almost as important as Russia for the European investors both in terms of project number and investment capital. But India receives also lots of projects from other countries and the share of the EU there is rather low.

3.4 Investors target mainly local and regional markets

Of the more than six thousand EU investment projects 1382 provided information concerning the markets their activities serve. One third of these investment projects targeted only the domestic market of the host country, another one third the Asia-Pacific market, and 7% had global destination. Only 63 projects had the aim to serve European markets, which shows that the role of outsourcing is rather small. Most projects serving the EU market were in Russia, the geographically nearest of the BRICs.

The motives of EU investments in the BRICs were related to the market conditions in the host country and the direction of sales (Table 7). Of the 1445 projects which supplied information 45% chose the location due to the growth potential of the destination market, 17% due to the proximity to customers and only 7% due to low costs. The motivation of investors and the markets of their products reveal that European FDI in the BRICs is primarily market seeking. It is the growth of the market, less the production cost which motivates investments. This structure of motivations suggests that when in the wake of economic growth wages will increase, this will not deter investors due to rising costs, but rather attract them due to growing demand.

Table 7

Motives of EU15 investors in the BRICs

Location determinants (motives)	**Projects**	**% of projects**
Domestic Market Growth Potential	644	44,6
Proximity to markets or customers	251	17,4
Lower Costs	104	7,2
Skilled workforce availability	94	6,5
Industry Cluster / Critical Mass	76	5,3
Infrastructure and logistics	67	4,6
Regulations or business climate	62	4,3
Presence of Suppliers or JV Partners	33	2,3
IPA or Government support	23	1,6
Natural Resources	22	1,5
Attractiveness / Quality of Life	14	1,0
Universities or researchers	13	0,9
Language Skills	12	0,8
Finance Incentives or Taxes or Funding	10	0,7
Technology or Innovation	8	0,6
Facilities Site or Real Estate	8	0,6
ICT Infrastructure	4	0,3
Total January 2003 – January 2009	1445	100,0

Source: FDI Intelligence from Financial Times Ltd.

3.5 EU strong in financial services and manufacturing, weak in IT

According to the distribution of projects (all investors) in the BRICs by economic sectors (Table 8) the software and IT services are in the first place and financial services in the second[24]. Services together including also business services and real estate, account for 37% of the projects. The rest are in manufacturing branches, most importantly in the automotive industry (original equipment manufacturing, OEM and car component industry together), machinery and equipment, chemicals and food. As to the investors from the EU, financial services are in the first place by the number of projects. These are followed by manufacturing industries like machinery, textiles and automotive. Software and IT services rank only fourth and also electronic components and communication have lower shares

[24] In this classification there are no data for wholesale and retail trade, thus the manufacturing branches cover not only production but also distribution.

than the average. This allows to conclude that EU investors are relatively weak in the most modern services and products.

There are some remarkable changes over time like the shift of total FDI towards services. But this does not relate to all activities. In the software and IT sector the peak years were 2004-2007. Financial service projects had the highest number in 2008 after steady growth for five years. A similar trend can be observed for machinery and equipment manufacturing, business services and especially the real estate sector which became the fifth most important activity in 2008 after having occupied place 15 in 2003. The automotive OEM had its peak in 2004 and the components industry in 2008, a clear shift from the one to the other type of car component production. In the case of EU investors the shift to services is weaker, especially to IT while it is more pronounced in business services and real estate. There is also a strong shift to machinery and textiles industries which are less frequented by investors from other parts of the world.

Table 8

Investment projects in the BRICs by economic sectors

	World			EU15 investors		
Sector	**Total no.**	**% of Total**	**% of FDI capital**	**Total no.**	**% of total**	**% of FDI capital**
Software & IT services	1,913	10.9	1.1	342	5.5	0.9
Financial Services	1,446	8.3	0.7	547	8.9	0.1
Machinery, Equipment	991	5.7	1.3	423	6.8	2.0
Business Services	965	5.5	0.2	330	5.3	0.2
Chemicals	870	5.0	7.2	341	5.5	12.5
Food & Tobacco	773	4.4	2.5	319	5.2	3.7
Textiles	689	3.9	0.6	423	6.8	0.6
Electronic Components	681	3.9	3.2	193	3.1	1.4
Metals	680	3.9	13.8	253	4.1	20.1
Communications	679	3.9	1.7	235	3.8	1.4
Consumer Products	661	3.8	1.5	329	5.3	3.6
Transportation	647	3.7	7.6	255	4.1	3.9
Automotive Components	640	3.7	1.8	267	4.3	2.7
Real Estate	571	3.3	12.5	185	3.0	5.7
Automotive OEM	559	3.2	7.8	234	3.8	9.1

Source: FDI Intelligence from Financial Times Ltd

By the amount of invested capital, the capital-intensive sectors lead the list: metals (14% of total), real estate, oil and gas (10%), automotive OEM (7.8%). For the EU these shares are even more pronounced, 20% for the metal sector and 12.5% for chemicals. Services have only low shares as they are not capital-intensive. Financial services have especially low equity, although they may transmit high amounts of investments in the form of credits.

Another classification is by business activity (Table 9) which contains broad categories for the functions of the investment project. Manufacturing, separated from the related wholesale and retail activity, still comprises the largest category with one third of the projects and 59% of the invested capital invested in the BRICs from the world and 35% of the projects and 68% of the capital invested from the EU. This outlines the strength of EU investors in production while other investors are stronger in sales, and construction. Typical offshore services, like call and support centres are also less common with European investors. At any rate, the fDi database seems to provide a more realistic and more divers picture about the specialization of EU investments in the BRICs. The role of manufacturing is higher and that of financial and business services more constrained.

Table 9

Investment projects in the BRICs by major business activities

Business Activity	Total number	Total Number %	Invested Capital %	EU number	EU number %	EU invested capital %
Manufacturing	5914	33.8	59.0	2188	35.4	68.4
Sales, Marketing & Support	3045	17.4	0.4	931	15.1	0.4
Business Services	1819	10.4	0.6	677	11.0	0.9
Retail	1701	9.7	2.6	892	14.4	5.4
Design, Development & Testing	1137	6.5	1.9	239	3.9	2.0
Construction	819	4.7	15.9	302	4.9	7.7
Logistics, Distribution & Transportation	775	4.4	8.9	305	4.9	5.5
Research & Development	609	3.5	1.1	145	2.3	1.0
Headquarters	391	2.2	0.4	126	2.0	0.9
Extraction	247	1.4	5.2	75	1.2	4.9
Shared Services Centre	174	1.0	0.1	47	0.8	0.1
Education & Training	164	0.9	0.1	53	0.9	0.1
ICT & Internet Infrastructure	159	0.9	0.6	39	0.6	0.4
Maintenance & Servicing	156	0.9	0.1	62	1.0	0.1
Technical Support Centre	141	0.8	0.1	24	0.4	0.0
Customer Contact Centre	137	0.8	0.0	40	0.6	0.0
Electricity	80	0.5	2.8	31	0.5	2.2
Recycling	18	0.1	0.1	3	0.0	0.0
Overall Total	**17486**	**100.0**	**100.0**	**6179**	**100**	**100.0**

Source: FDI Intelligence from Financial Times Ltd

The specialization of the EU investors in the BRICs follows the general comparative advantage of each country (see highlight reports below). Manufacturing activities are most prominent in Brazil and China, less in Russia and India. Trade and distribution are most widespread in Russia and China. The Software and IT sector is concentrated in India. The largest EU companies are the main investors first of all from Germany, except in Brazil where a Portuguese real estate developer is the top investor.

3.6 EU FDI highlights in individual BRIC countries[25]

Brazil Report Highlights

- Between January 2003 and December 2008, fDi Markets recorded a total of 539 investment projects from 306 EU15 companies
- The leading sector was Chemicals, which accounted for 8% of projects.
- The leading business activity was manufacturing, which accounted for 46% of projects.
- The top ten companies accounted for 18% of all investment projects with Sonae (Portugal), Fiat (Italy) and Akzo Nobel (Netherlands) among the top 10 companies.
- The key influencing factors behind the location of investment projects were Domestic Market Growth Potential and Proximity to markets or customers, cited by 42% and 38% of companies respectively.

Russia Report Highlights

- Between January 2003 and January 2009, fDi Markets recorded a total of 1446 investment projects from 696 EU15 companies
- The leading sector was Food & Tobacco, which accounted for 10% of projects.
- The leading business activity was manufacturing, which accounted for 33% of projects.
- The top ten companies accounted for 17% of all investment projects with Metro (Germany), IKEA (Sweden) and Raiffeisen Zentrabank (Austria) among the top 10 companies.
- The key influencing factors behind the location of investment projects were Domestic Market Growth Potential and Proximity to markets or customers, cited by 76% and 20% of companies respectively.

India Report Highlights

- Between January 2003 and January 2009, fDi Markets recorded a total of 1497 investment projects from 709 EU15 companies
- The leading sector was Software & IT services, which accounted for 11% of projects.
- The leading business activity was manufacturing, which accounted for 33% of projects.
- The top ten companies accounted for 11% of all investment projects with Deutsche Post (Germany), cargo-partner (Austria) and Volkswagen (Germany) among the top 10 companies.
- The key influencing factors behind the location of investment projects were Domestic Market Growth Potential and Proximity to markets or customers, cited by 61% and 20% of companies respectively.

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[25] Results based on FDI Intelligence from Financial Times Ltd.

China Report Highlights

- Between January 2003 and January 2009, fDi Markets recorded a total of 2398 investment projects from 1108 EU15 companies
- The leading sector was Financial Services, which accounted for 9% of projects.
- The leading business activity was manufacturing, which accounted for 40% of projects.
- The top ten companies accounted for 13% of all investment projects with HSBC (UK), Siemens (Germany) and Carrefour (France) among the top 10 companies.
- The key influencing factors behind the location of investment projects were Domestic Market Growth Potential and Proximity to markets or customers, cited by 65% and 24% of companies respectively.

3.7 BRICs expand to Europe

All BRICs are on an international expansion course for some years now (Table 10). By the number of projects India is ahead of China: Not only in the 2003-2008 period as a whole, but also in 2008 Indian companies established more project in the EU15 than Chinese. For instance, the Tata Group has IT and telecom services centres in several larger European cities. As to the invested capital, Russia is the largest investor ahead of China and Hong Kong; all in all very few projects report the amount of investment.

Table 10

FDI in the EU15 from the BRICs, number of projects and invested capital

Source Country	2003	2004	2005	2006	2007	2008	2009	Total
India	24	33	40	48	36	64	9	254
China	12	22	37	22	57	55	3	208
Russia	8	17	18	15	18	17	2	95
Hong Kong	10	15	15	15	12	22	3	92
Brazil	5	9	5	7	5	14	3	48
Total	**59**	**96**	**115**	**107**	**128**	**172**	**20**	**697**

The main target countries of BRICs investments are the UK (248 projects), Germany (118) and France (75); in 2008 also Spain. The UK is on the top due to its business and language links and serves as distribution centre to the rest of the EU.

4 Impact of the crisis on EU–BRICs FDI relations

World trade and FDI have developed hand in hand in recent decades, with FDI outpacing trade in boom periods, and declining more than trade in slowdown or recession periods. Much of the international trade is a result of FDI, generated by the intra-firm trade of multinational companies. The question is what happens to the FDI in the current global economic contraction?

According to the World Bank (2009), global industrial production contracted by 20% in the last quarter of 2008. In 2009 advanced economies are estimated to contract by at least 2% and their imports by 3%. This will trigger the contraction of close to 1% of the exports from emerging and developing economies. In addition, trade finance has shrunk by some 40% and its costs increased substantially. Countries dependent on exports to the US are especially hard hit. In December 2008 Brazil reported 29% plunge of exports and a trade deficit first time in this decade.

According to a more recent forecast issued by the OECD (2009a), the global economic decline will be as much as 2.7% while the OECD members will contract by 4.3% in 2009. In the Euro-area, GDP is going to drop by 4.1% in 2009 and 0.3% in 2010. World trade is going to contract by as much as 13% in 2009. The crisis will not only be deeper but it will also last longer than assumed earlier. Among the BRICs the Russian economy is expected to contract by 5.6%, but Brazil only by 0.3%, while India will grow by 4.3% and China by 6.3% according to OECD. Although the two largest emerging economies will grow much less than earlier, their results will be the bright spot.

What can be expected for FDI under there circumstances? Economic decline will most likely trigger a drop in FDI due to falling global demand, excess capacities, difficulties of investment financing, drop of subsidiary profits, etc. Overcapacities will hinder FDI and cause its volume to shrink perhaps even more than the volume of global trade. Export oriented industries, many of them foreign subsidiaries are already cutting output and putting their capacities idle. Tight credit conditions will also diminish FDI. This will happen in two ways, credit-type FDI will shrink and the financing of equity FDI will become more rare and costly. Ongoing projects can be cancelled or delayed due to the lack of affordable financing. In additions, FDI in the oil, gas and metals industries decline due to low commodity prices. An important part of FDI is reinvested profits, and when profit shrinks, less can be reinvested. In addition, profits may be withdrawn by parent companies from more affluent locations to finance losses elsewhere. On a sectoral dimension, the drop in FDI flows is expected to be most significant in financial services, automotives industries and building materials (UNCTAD, 2009).

The BRICs may have a privileged position in many respects. First of all they are large economies where FDI is mainly attracted by the local markets with growth expectations above world average, with the possible exception of Russia. Local economic growth will allow for FDI to grow if companies from crisis-hit countries are in the position to invest there. Larger multinationals may just concentrate on the very few countries in the world where they can expand sales such as China, India, Brazil and shift investments there. Also for European companies the expansion to the BRICs remains a major attraction if economic growth continues there. Due to the size of the BRICs and their distance to Europe, only larger or more specialized investors may benefit from this opportunity.

A major driving force of global FDI in recent years has been mergers and acquisitions. European banks, telecom companies, etc. have acquired positions in Brazil and elsewhere. M&A deals usually flourish when capital is abundant and relatively cheap and they are to contract in times of falling stock markets and high costs of financing. Due to the current crisis, there will be a lack of capital in European companies for expansion. One can expect the number and even more the value of M&As to contract. If BRICs companies fare better than Europeans and their financial situation stays more robust, they will even invest in relatively cheap EU companies. Thus outward FDI from the BRICs may increase[26].

The decline of global FDI may come with some delay following the decline of output and trade. This was shown by OECD quarterly figures for 2008 (OECD, 2009b). OECD FDI inflows declined by 25% per quarter in 2008 but outflows only by 5%; they even increased in the last quarter. This shows that developed countries still had the capital to invest and found attractive targets, most probably in the BRICs. The same source refers to the expectation that FDI will be more resilient than other capital flows to developing countries. It also concludes that global M&A may increase especially from developing countries.

Current economic growth and FDI forecasts suggest that competitiveness of EU companies will not be endangered by US or Japanese firms as the declines there will be at least as harsh as in Europe. In the BRIC economies developed countries will compete with each other and also with domestic and other BRIC companies.

5 Summary and conclusions

On a global level, the EU emerges as the most important foreign direct investor, also if considering extra-EU investments only. This reflects the capability and propensity of EU firms to internationalize their business activities. The size and specialization of both inward and outward FDI of the EU shows the results of internationalization, the strong and weak points in terms of competitiveness. A joint analysis of two methodologically very distinct

[26] In Brazil the expectation is that, in three to five years, five banking giants will control 85% of the market, one public bank (Banco do Brasil), two Brazilian-owned private banks (Itaú Unibanco and Bradesco), and two foreign banks (Santander and HSBC) (see: http://www.latinbusinesschronicle.com/app/article.aspx?id=3049). There are two potential consequences that may arise as a result of such a significant merger: a stronger wave of consolidation in Brazil, and an international expansion. Itaú Unibanco, now the 17th largest company in the world, declared plans to become the first Brazilian financial institution to become a global player, starting with Latin America. The company anticipates its first move out of the region in five years, after consolidating its position in Latin America, where Itaú already has operations in Argentina. Similar trends can be seen in the case of larger companies from other BRICs.

databases, Eurostat FDI data and the *'fDi database'* on investment projects (FDI Intelligence from Financial Times Ltd.) made it possible for the period 2001-2007 and 2003-2008, respectively, to reveal several facts and trends concerning the competitive position of EU firms in the BRICs and vice versa. Many findings of the two databases are similar. In other cases the results complement each other.

One of the most robust results is that the EU is among the main investors in each of the BRICs and the dominant investor in Brazil and Russia. According to Eurostat the EU provided on average 53% and 57% of the FDI inflows in Brazil and Russia, respectively (2004-2007 average). This dominant role is confirmed by the number of projects as reported in the fDi database, 42% in Brazil and 54% in Russia. In China and India, the EU has less weight. But after correcting for particularities in FDI data, such as the prominent role of Hong Kong and off-shore centres in Chinese FDI and of Mauritius in Indian FDI, the EU ranks higher also in these countries. The analysis of the number of projects confirms this finding, the role of the EU in China is much greater (29% of all reported projects in the country) than those suggested by FDI data. China emerges as the main BRICs target for EU projects, but in terms of FDI inflows China occupies rank three after Russia and Brazil. Divergent results can be explained by a small number of very large projects in the natural resource sector of Russia and the great number of finance and trade related small investments in China.

The magnitude of EU FDI flows to the BRICs relative to the United States and Japan suggests that EU firms are well positioned to compete with other MNCs in the BRICs: among the Triad countries, the EU is the leading FDI investor in each single BRIC country, in the case of Brazil and Russia by a wide margin. The EU is even better positioned in the BRICs when it comes to internationalization via FDI than via trade in goods and services. Moreover, the magnitude of sales by foreign affiliates in comparison to exports suggests that, in some cases, FDI has become the major entry strategy of EU firms into the BRICs markets. FDI is important for entering into the markets of the BRICs for US and Japanese firms as well.

EU FDI flows to the BRICs have increased steadily over the period 2001-2007. However this growth was more or less in line with the overall expansion of EU FDI. The share of the BRICs in the EU's outward FDI stocks increased by only 2.5 percentage points over the 2002-2007 period to reach approximately 10% in 2007, more slowly than what the growth performance of the BRICs would suggest. The exception is Russia, where EU outward stocks increased rapidly, while the share of China plus Hong Kong even declined. It is difficult to find reasons why the EU is not more prominently present in China. Returns on EU FDI in the BRICs is higher than in the new EU member states thus low profitability or better investment opportunities elsewhere (such as in the new EU member states) cannot explain the slow pick-up of the BRICs' weight in EU outward stocks. But the fDi database paints a somewhat different picture with a very dynamic increase in the number of projects in all BRIC countries. The share of the EU-15 in the total number of projects to these countries increased from 32% in 2003 to 38% in 2008. This points to a growing importance of the EU as an investors in the BRICs. Half of the EU FDI projects went to China and Hong Kong all through the 2003-2008 period. Methodological differences explain to a large extend why the two databases give such diverging picture of EU FDI in China, but also the country of origin and the sectoral structure play some role.

The larger countries of the EU account for the bulk of FDI flows. These are, in sequence of importance the United Kingdom, Germany, France, Spain, and the Netherlands. Especially the United Kingdom and Spain have strong focus of their FDI activities on the BRICs. In the case of the United Kingdom, Hong Kong is the primary target whereas for Spain it is Brazil. As to the number of new projects, Germany and United Kingdom lead the list. Italy emerges to be very involved in new projects, whereas Spain much less. Such differences can be connected to the size and industry structure of investors in the two countries. For similar reasons, Portugal emerges by the number of projects as the top investor in Brazil (numerous real estate projects), while it is absent from the top five list in terms of invested capital.

The split-up of EU investment in the BRICs by economic activities reveals that approximately one third of the EU FDI is in manufacturing and about 60% in the services industry. This distribution across broad economic sectors is similar in both databases but major differences emerge at a more detailed level. Especially, the role of financial services, which is the dominant industry for EU FDI in each of the BRICs, is suggested to be much smaller according the number of projects in the *fDi database* than in terms of FDI flows. A good part of this difference can be explained by the fact that Eurostat data contain other capital flows, including intercompany loans which are typically very important between affiliated banks and not covered by the *fDi database*. The latter, in turn, mark trade and distribution activities very important especially in Russia and China.

In terms of EU FDI stocks in China and India, services and manufacturing are of equal importance. In both countries existing barriers to FDI are most prominent in service and infrastructure industries that may contribute to the relatively large share of manufacturing. As to the number of projects, manufacturing is strongest in China and Brazil. The analysis of fDi data also reveals that EU firms have more projects in manufacturing industries than other investors. They are strong in machinery and chemical industries but relatively weak in IT. EU investments in the IT and software sector is concentrated in India but also there their investments fall behind those of the USA.

Concerning the motives for FDI, the *fDi database* reveals that EU investors target mainly the local and regional markets of the BRICs, thus they can be considered as market seeking. Exporting the products of the investments back to the EU is negligible, although manufacturing investors usually follow a mixed strategy. This structure of motivations suggests that when in the wake of economic growth wages increase, this will not deter investors due to rising costs, but rather attract them due to growing demand. Balance of payments data are unable to identify the motives for FDI but the industry distribution of FDI as it emerges from Eurostat, in particular the strong focus on services, makes the market-seeking motive plausible.

It is also important to stress that global and EU-15 investments in the BRICs, as measured by the number of investment projects, were resilient to the global crisis until 2008. With regards to the current economic downturn and the expected drop in global FDI, the BRICs may find themselves in a privileged position in several respects. First of all they are large economies where FDI is mainly attracted by the local markets with growth expectations above world average, although not in Russia. Local economic growth especially in China and India will allow for FDI to grow if companies from crisis-hit countries will be in the position to invest. Larger multinationals may increasingly concentrate on the very few countries in the world where they can expand sales such as China, India, Brazil and shift investments there. Also for European companies the expansion to the BRICs remains a major attraction. Due to the size of the BRICs and their distance to Europe, only larger or more specialized investors may benefit from this opportunity.

Turning to the FDI activities of the BRICs in the EU, the most important conclusion is that the investment activities of the BRICs remain at a low level. All BRICs are on an international expansion course recently. By the number of outward FDI projects India is ahead of China. The EU is not the primary destination of the expansion as confirmed by both databases. The share of the BRICs (including Hong Kong) in total EU inward FDI flows is small, amounting to only 5.5% on average during the period 2002-2007 with no clear trend over time. This is lower than their share in global FDI which stood at 7.1% in 2007. One major explanation for this pattern is that a large part of the BRICs' FDI is resource-seeking, particularly of China and India which targets Asia and Africa. Brazil is still rather a regional than a global player. For Russia the neighbouring EU is a major outward FDI target region, and by the amount of invested capital it is the most important BRIC investor there.

The main EU target countries of BRICs investments are the United Kingdom, Germany and France; in 2008 also Spain by the number of projects. The United Kingdom is on the top due to its business and language links and serves as distribution centre to the rest of the EU. The services sector is very dominant leaving only marginal amounts to manufacturing (with the partial exception of India). Business services and financial intermediation emerge as the major industries.

The low level of FDI activity of the BRICs in the EU leads to the conclusion that the preferred channel of competition for BRICs' firms in the markets of the EU (but also the US and Japanese markets) remains exports. For the EU this means that EU firms experience only very limited competition from the BRICs via the FDI channel. The downside of this is that the BRICs as FDI investors only create limited additional investment and employment opportunities.

The main conclusion based on the statistical analysis is that the EU is well positioned as a direct investor both on the global level and in the BRICs. In the fast growing markets of China and India, however, the share of EU firms in total FDI is rather low and not particularly dynamic. As investments in such geographically more distant places are mainly realized by large corporations and SMEs typically limit their foreign operations to nearby countries, policy levers may be necessary to expand EU presence there. This is all the more desirable as China and India have high market potential and EU firms can expect high returns on FDI.

Policy obstacles to EU FDI in the BRICs exist in the form of various restrictions. FDI is limited in several industries important to the EU investors, such as finance or telecommunication. EU trade policy should seek to eliminate such obstacles, including caps to foreign ownership. Restriction of foreign ownership can also not be in the interest of the BRICs in instances where it blocks the transfer of technology.

The EU is a much more open economy to FDI than the BRICs but obstacles to investment nevertheless exist. Critical in this respect is the informal discrimination against investors from the BRICs. Especially asset-seeking FDI is considered strategic and undesirable because it would give investors access to EU technologies and cause dependence. As China's outward FDI is dominated by state-controlled enterprises in natural resources or telecommunication most of which enjoy a monopoly or monopoly-like situation in the Chinese economy their expansion abroad may distort fair competition. The guidance for EU policy has been its strong commitment to open markets and fair competition and this may prevail over other concerns when dealing with investment issues of the BRICs. The EU may thus be interested in a process of further mutual and balanced liberalization in the area of FDI to eliminate obstacles on both sides.

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