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Trends and Pattern of Foreign Direct Investment: Evidence from BRICS

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Abstract

In the recent past, the world economy has witnessed a paradigm shift having moved away from isolated national economies constrained by barriers to cross-border trade and investment towards an interdependent global economic system. Due to such transformation, there has been a surge in foreign direct investment (FDI) flows across the globe. Over the last three decades, there has been a huge increase in both the flow and stock of FDI in the world economy. The fastest growing BRICS (Brazil, Russia, India, China and South Africa) economies have played a remarkable role in the changing global investment landscape. The BRICS countries are considered as the fastest emerging economies whose markets are developing significantly. The spectacular rise in FDI flows in BRICS group of countries, projecting these economies as the significant players in the foreign investment scene has motivated the current study. The present research focuses on analyzing the trend and sectoral pattern of foreign direct investment in BRICS nations. An overall rising trend is observed in both FDI inflows as well as outflows during the period 1990-2017, while the sectoral pattern of FDI inflows has witnessed a substantial change over the years in these emerging economies with services sector having emerged as the most favoured FDI destination.

Keywords: Foreign Direct Investment, FDI, BRICS, Sectoral Pattern.

INTRODUCTION

The role of investment in enhancing the economic growth of a country has remained a topic of great interest among academicians, economists and policy makers. Investment leads to capital formation in an economy and the capital is pivotal for channelizing the productive economic activities, which later on translates into economic growth. Developing countries have been continuously developing an investment policy framework aimed at attracting foreign capital into their economies.

Foreign direct investment (FDI) is defined as an investment reflecting a lasting interest and control by a foreign direct investor, resident in one economy, in an enterprise resident in another economy **(UNCTAD, 2018a)**. Foreign Direct Investment (FDI) occurs when a firm invests directly in facilities to produce or market a product in a foreign country **(Hill, 2011)**. In today's globalized era, FDI is considered to be one of the key developmental strategies adopted by countries across the globe. Foreign direct investment not only supplies capital but also transfers valuable technology and know-how to the host economy. It is due to such advantages offered by FDI that many countries have removed restrictions on foreign direct investment in a progressive manner. In order to attract FDI to their

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economies, developed as well as developing countries have increasingly offered incentives like subsidies for infrastructure and tax holidays to foreign firms over the last decades **(Alfaro, Kalemli-ozcan, & Sayek, 2009).**

The FDI inflows to developing economies have witnessed an immense surge and BRICS economies have played a significant role in this paradigm shift in the global investment. BRICS is an acronym for the world's leading developing economies, namely Brazil, Russia, India, China and South Africa. In the recent decades, BRICS nations have shown significantly high growth rates drawing remarkable attention on the scene of international business and global economy. BRICS as a group has assumed a significant role in the world economy, accounting for over 40% of the world's population, 26.7% of world's geographical area spread over four continents and nearly a quarter of global GDP. These countries are classified as "emerging economies" aimed at reaching the level of world's leading economies in a short span of time. The attention of global economy may gradually shift away from the developed economies of the world, such as the G7, towards these emerging economies. It is against this backdrop, that present paper makes a modest attempt to study the pattern of Foreign Direct Investment in BRICS nations.

Review of Literature

The concept of BRIC (Brazil, Russia, India and China) originated in the year 2001 when the term first appeared in a Global Economic series' research paper by Jim O'Neill, then chairman of Goldman Sachs, one of the leading investment management companies of the world. **O'Neill (2001)** assessed the relationship between the world's leading economies and some emerging-market economies in terms of their economic might. He observed that China's GDP was quite bigger than that of Italy, an important member of G7 group. It was predicted that the GDP growth in Brazil would not be far behind Italy in 2011 and this turned out to be true. In 2010, Brazil overtook Italy in terms of GDP, making it the seventh largest economy in the world having a GDP of $2.1 trillion. While undertaking a modelling exercise for the global economic trend, he forecasted that the BRIC countries would grow significantly over the next ten years, contributing largely to the global GDP. Given such prospects, it was felt that the global policymaking forums should be modified in general and G7 group be re-organized in particular to include the BRIC countries' representatives. The work of O'Neill was extended further by his colleagues at Goldman Sachs to the middle of the century. **Wilson & Purushothaman (2003)** forecasted the economic growth in the BRIC group of countries until 2050. They predicted that these economies have the tendency to become a much bigger power in the global economy over the next five decades.

Sustained economic development in BRICS nations, coupled with a growth-oriented strategy followed by these nations since the 1990s have led to significant improvement in their infrastructure base. These economies experienced higher economic growth rates and huge market size, thereby were able to attract foreign capital **(Singh & Dube, 2011)**. BRICS economies have witnessed a spectacular rise in FDI inflows **(Kapoor & Tewari, 2010; Nistor, 2015)** and have received 15 percent of global FDI flows in 2015 **(UNCTAD, 2016).** In order to attract FDI inflows, these countries offer many benefits to foreign investors like cheap labour, natural resources and huge markets. **Ranjan & Agrawal (2011)** revealed that trade openness, market size, macroeconomic stability, labor cost, and growth prospects are the main determinants of FDI inflows in BRIC countries, while **Vijayakumar et al. (2010)** found in his study that market size, labour cost, infrastructure, currency value and gross capital formation were found to be the potential determinants of inward FDI flows into these economies. The emerging economies may continue to attract inward FDI if they offer favorable market characteristics to foreign investors **(Bose & Kohli, 2018)**.

Duan (2010) undertakes the analysis of industrial pattern of FDI inflows in BRIC economies and finds that in Brazil, Russia and India, the tertiary sector is the major recipient of inward FDI flows followed by secondary and primary sectors. In China, secondary sector receives the major portion of total FDI inflows whereas the primary and tertiary sectors receive a little amount of inward FDI. Some researchers **(Agrawal, 2015; Hayrdaroglu, 2016)** have focused on the FDI-growth nexus in BRICS economies revealing a positive impact of FDI on growth**. Joo & Dhar (2019)** conducted a sectoral study aimed at examining the role of inward FDI on economic growth in India and the findings revealed that the growth performance of FDI is not uniform but varies across sectors.

Objectives of the Study

The present study aims at to achieve the following objectives:

1. To analyze the trend of Foreign Direct Investment inflows in BRICS nations.
2. To analyze the trend of Foreign Direct Investment outflows in BRICS nations.
3. To examine sectoral pattern of Foreign Direct Investment in BRICS nations.

Trend of Foreign Direct Investment Flows in BRICS

The liberal policy framework set up by the BRICS countries has led to a marked increase in foreign capital flows. As per the latest UNCTAD database, it is clear that FDI inflows have increased enormously in BRICS economies as is evident from Figure:1. Data demonstrates that inward FDI flows have increased tremendously from nearly $4634 mn in the year 1990 to $265557 mn in 2017. The factors like excess international liquidity, changing risk perception towards emerging economies and expectation of higher returns from foreign investment are largely responsible for the rising trend of FDI inflows in favour of emerging market economies **(The BRICS Report, 2012)**.

According to UNCTAD Handbook of Statistics, Brazil, Russia, India and China figure among the top 20 host economies for FDI inflows in the year 2017 with China ranking second, Brazil fourth, India tenth and Russia sixteenth **(UNCTAD, 2018b).**

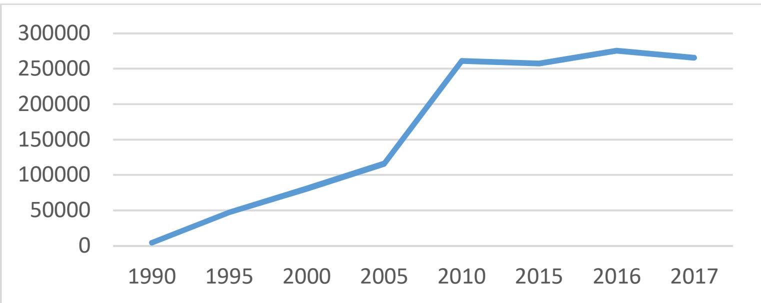

Figure: 1-FDI Inflows in BRICS ($ mn)

Source: *UNCTAD*

The overall trend of outward FDI flows is similar to that of inward FDI flows in BRICS economies. There has been a sharp increase in FDI outflows in these countries as can be observed from Figure:2. The FDI outflows have increased from about $1488 mn in the year 1990 to $177974 mn in 2017 in the BRICS nations. The overall rising trend of outward FDI flows substantiates the argument that the BRICS economies are not only the major FDI destinations but also assume a significant role in meeting the international demand for capital.

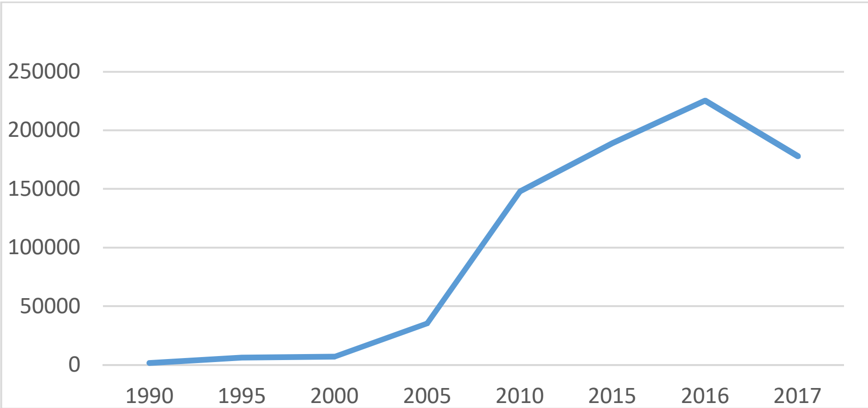

Figure: 2-FDI Outflows in BRICS ($ mn)

Source: *UNCTAD*

Sectoral Pattern of Foreign Direct Investment Inflows in BRICS

The previous section outlined the overall trend in FDI flows in BRICS economies, it is equally important to analyze the sectoral pattern of FDI inflows in these nations, so to have idea about the sector receiving maximum FDI. The sectoral distribution of FDI inflows in the countries is different from each other and there have been substantial changes in the FDI inflow pattern over a period of time. In order to examine the country-wise analysis of the industrial pattern of inward FDI flows in BRICS, the next section presents the detailed analysis of each nation of BRICS bloc.

Brazil

Brazil is the largest country in South America and fifth largest in the world in terms of population and territory. The country is rich in natural resources and is a major producer of iron ore, tin and phosphate in the world. With a GDP of US$1.868 trillion, Brazil is ranked as the ninth largest economy in the world. Brazil witnessed a period of considerable socio-economic progress between 2003 and 2014, when nearly 29 million people have come out of poverty. According to World Bank, the income level of 40% poor population in the country rose by 7.1% during this period.

The Brazilian government has played a significant role in encouraging foreign investors to consider Brazil as an important investment option. Due to the liberal investment regime followed by Brazil, it has been successful in attracting the inward FDI flows. The FDI inflows into Brazil boomed during the period 2009–2011 and declined thereafter. The FDI inflows reached US$64 billion in 2013, decreased to

US$62 billion in 2014, US$56 billion in the year 2015 and in 2016 to US$50 billion. Brazil has remained the largest recipient of FDI in Latin America but in the year 2018, FDI flows to Latin America decreased by 6 per cent to US$147 billion where the flow declined most in Brazil **(UNCTAD, 2019)**.

The sectoral pattern of FDI in Brazil has undergone a change over the years. During the period 2000 to 2009, a dramatic change has been observed in the sectoral distribution of inward FDI. In 2000, the tertiary sector received highest share, 72 percent of the total FDI inflows. However, in 2009, the share of tertiary sector decreased to 43 percent. The shares of primary and secondary sectors in total FDI inflows increased from 3% and 15% respectively in 2000 to 14.5% and 43% in 2009. In the subsequent period (2010-2013), the share of FDI in the services sector was again low compared to previous years, and it ranges between 44% and 46%. The manufacturing industry attracted 38% and the primary sector attracted 12% of total FDI inflows. FDI inflows in agriculture, livestock and mining have declined significantly and in the industrial sector, a downward trend has been observed since 2014. In 2016, 55 percent of the total FDI inflows related to services, the largest share in the series **(Central Bank of Brazil, 2018)**.

The major sectors that attract foreign investment in Brazil are financial services, beverages, oil and gas, and telecommunications. Figure:3 shows the sectoral distribution of FDI inflows in Brazil during the period 2010-16.

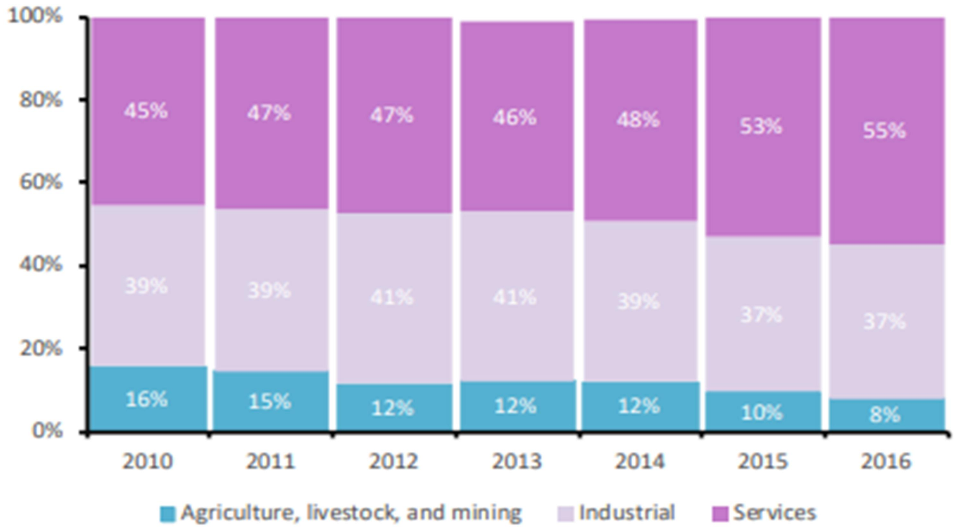

Figure: 3- Sectoral Pattern of FDI inflows in Brazil

Source: *Central Bank of Brazil*

Russia

Russia is home to a variety of natural endowments such as oil, natural gas, iron, copper, nickel, zinc, tin, gold, silver and so on. Russia ranks 11th in global GDP ranking in 2018 and its GDP is recorded at US$1.63 trillion. Being an export-oriented economy, the value of export of natural resources is estimated at US$844 billion by Natural Resources and Environment Ministry of Russia, contributing

60% to the country's GDP. After attracting highest FDI inflows in 2013, there has been a considerable decline since 2014 due to geopolitical tension between Russia, Ukraine, and West, and also due to the economic crisis in the country. The inward FDI flows declined by 92 per cent in 2015 compared to 2014. In 2016, FDI inflows increased to US$19 billion, an increase of 62 percent compared to the previous year. The FDI inflows halved in 2018 and declined from US$26 billion to US$13 billion **(UNCTAD, 2019)**.

Table:1- Industry-wise Foreign Direct Investment Inflows of Russia

(Balance of Payment Data: Millions of US Dollars)

Economic Activity	2013	2014	2015	2016	2017	2018
T O T A L	**193,685**	**146,370**	**133,949**	**137,763**	**150,433**	**140,398**
Agriculture, forestry and fishing	934	598	671	446	448	371
Mining and quarrying	26155	16339	17435	32384	28477	30176
Manufacturing	51750	26741	32013	34058	33069	35945
Electricity, gas, steam and air conditioning supply	2831	3251	1120	1143	2265	1980
Water supply; sewerage, waste management and remediation activities	28	14	27	48	13	23
Construction	5771	4812	2078	1983	3214	1427
Wholesale and retail trade; repair of motor vehicles and motorcycles	43903	32353	37998	32126	33461	22723
Transportation and storage	2899	3607	2262	3697	3156	2875
Accommodation and food service activities	332	386	461	364	462	803
information and communication	5305	3072	2466	1701	4605	3585
Financial and insurance activities	31102	31625	18714	14124	18362	16761
Real estate activities	7732	7722	5789	5226	7245	3834
Professional, scientific and technical activities	255	231	151	306	12172	13916
Administrative and support service activities	488	833	203	216	1165	4104
Public administration and defence; compulsory social security	0	0	0	0	1	2
Education	3	10	4	9	18	8
Human health and social work activities	446	341	139	132	198	198
Arts, entertainment and recreation	413	429	363	179	146	186
Other service activities	8685	11056	9974	7455	19	80
Activities of households as employers; undifferentiated goods-and-services-producing activities of households for own use	0	0	0	0	0	0
Activities of extraterritorial organizations and bodies	0	0	0	0	0	0
Unallocated	4652	2952	2081	2167	1939	1400

Source: *Central Bank of Russia*

In Russia, the services sector has been the major recipient of FDI inflows having a share of 58% of the total foreign direct investment inflows in 2007, followed by the manufacturing sector with a share of 25 % and mining & quarrying with a share of 17%. As is evident from Table:1, the sectoral distribution of FDI inflows has been almost static during the period 2003-07. As per the FDI database (2013) of Central Bank of Russia, the services sector continued to dominate the inward FDI flows. The major sectors attracting FDI flows are wholesale and retail trade, motor vehicles repair, manufacturing, insurance and financial services.

India

India is one of the largest economies of the world. Indian economy is the seventh largest in the world with a GDP of worth 2726.32 billion US dollars in 2018. Following the economic reforms of 1991, India has adopted a liberalized policy stance for foreign investment. There has been a surge in FDI inflows in India due to encouraging policy environment for foreign investors. Government of India has in place a policy framework on Foreign Direct Investment embodied in the circular on FDI policy issued by Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce & Industry. Considering the period from 2004-2018, a significant increase has been witnessed in inward FDI flows of India. In the year 2004, the FDI inflow was just US$5,777 million, which has swelled upto US$61,963.1 million in 2018, according to the data published by DIPP. It believed that in coming years also there is a positive and good expectation of FDI inflows (**Madaan, Bhandari, & Mishra, 2019).**

The sectoral pattern of FDI inflows has undergone a drastic change in India. As per the FDI data published by DIPP, the share of secondary sector in total FDI inflows has decreased in a substantial manner from 45% in 2000 to 27 % in 2009 while the share of services sector has surged from 16.5% in 2000 to 61% in 2009. Meanwhile, the share of primary sector in total inward FDI has increased from 0.12 % in 2000 to 9% in 2009. As is evident from RBI Data presented in the Table:2, the services sector continues to be the most favoured destination for foreign investment in India.

Table: 2- Sectoral Foreign Direct Investment Flows in India

(US$ million)

Industry	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-18 P**
Total FDI	16,054	24,748	36,068	36,317	37,366
Communication Services	1,256	1,075	2,638	5,876	8,809
Manufacturing	6,381	9,613	8,439	11,972	7,066
Retail & Wholesale Trade	1,139	2,551	3,998	2,771	4,478
Financial Services	1,026	3,075	3,547	3,732	4,070
Computer Services	934	2,154	4,319	1,937	3,173
Business services	521	680	3,031	2,684	3,005
Electricity and other energy Generation, Distribution & Transmission	1,284	1,284	1,364	1,722	1,870
Construction	1,276	1,640	4,141	1,564	1,281
Transport	311	482	1,363	891	1,267
Miscellaneous Services	941	586	1,022	1,816	835
Restaurants and Hotels	361	686	889	430	452
Real Estate Activities	201	202	112	105	405
Education, Research & Development	107	131	394	205	347
Mining	24	129	596	141	82
Trading	0	228	0	0	0
Others	293	232	215	470	226

Source: *Reserve Bank of India*

China

China, the world's most populous country is considered to be a global economic superpower today. With a GDP of $13.28 trillion (2018), China has been the second largest economy in the world since 2010. China is also the largest exporter and second largest importer of goods in the world. It is because of its huge population, military and economic might that China is characterized as a potential superpower of the world. China has emerged as one of the most favorable foreign investment destinations in the world. It has witnessed a growth in foreign direct investment inflows at a steady pace from several years. This growth is due to the liberalization policy framework, low labour cost, development of high-tech sector and setting up of free trade zones in the country. China is the second largest FDI recipient in the world, only behind U.S. In developing countries, China is the largest FDI recipient having attracted $139 billion FDI inflows in 2018, an increase of 4 per cent over the previous year **(UNCTAD, 2019)**.

The most lucrative sector for foreign investors in China is manufacturing which had a share of 54.7% in the total FDI inflows in 2007, followed by the tertiary sector, 38.7% according to the National Bureau of Statistics, China. The sectoral pattern of inward FDI has undergone a vast change in Chinese economy with services sector grabbing the major share of total FDI inflows. Inward FDI in services sector as a share of total FDI inflows increased from 41.1% in 2008 to 66.6% in 2016, whereas in the secondary industry the share fell from 57.6% to 31.9% over the same period **(KPMG, 2018)**. As is clear from the Figure:4, the share of secondary sector in total FDI inflows has declined continuously from the year 2004 and the share of tertiary sector has been increasing since then.

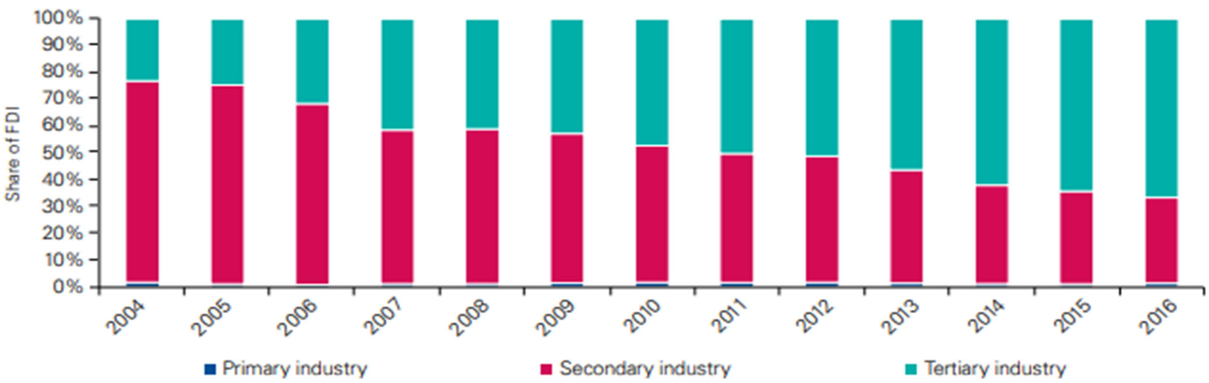

Figure: 4- Sectoral Pattern of FDI inflows in China

Source: *National Bureau of Statistics, China*

South Africa

South Africa is the smallest and most recent member of BRICS bloc having joined the group in 2010. It is the second largest economy in African continent after Nigeria, with a GDP worth 366.30 billion US dollars holding 32nd place in world GDP ranking in 2018. South Africa is the largest producer of chrome, manganese and platinum in the world. The country has followed an open investment regime and foreign direct investment has played an important role in its economic development, however, the legal uncertainty, violence and corruption have often acted as obstacles in realization of investment potential of the country. South Africa has undergone a sea change in the trend of FDI inflows witnessing periods of marked rise and decline over the years. However, the country after observing a sharp decline in inward FDI of nearly 41% in 2017 managed to reverse this declining trend by more than doubling the FDI inflows from $2 billion in 2017 to $5.3 billion in 2018 **(UNCTAD, 2019)**.

The sectoral pattern of FDI inflows in South Africa has shifted in favour of services sector. Over the past decade, the FDI inflows in services sector have outpaced the inflows in manufacturing and mining (primary) sectors. Services sector alone accounts for 51 per cent of total FDI inflows followed by the primary sector (mining) with a share of 31 per cent and manufacturing at 18 per cent **(UNCTAD, 2015)**. The considerable investment that increased South Africa's services sector share in total inward FDI was the purchase deal in financial industry by Barclays Bank of over 50 per cent of Absa Bank for R33 billion in the year 2005. Table:3 depicts the sectoral distribution of FDI inflows in 2016.

Table: 3- Sectoral Distribution of FDI Inflows in South Africa

Main Invested Sectors	Percent (in 2016)
Financial and insurance services, real estate and business services	42.1
Manufacturing	20.8
Mining	20.5
Transport, storage and communication	10.4
Trade, catering and accommodation	4.5
Community, social and personal services	1.5

Source: *South African Reserve Bank, Quarterly Bulletin June, 2018*

Conclusion

The global investment landscape has changed in a considerable manner owing to globalization of economies. The developing countries have attracted huge foreign capital inflows into their economies with the broader objective of achieving sustainable economic development. The liberal investment policy framework set up by the fastest growing BRICS countries has led to a marked increase in foreign direct investment flows. In this paper, an attempt has made to study the trend and sectoral pattern of foreign direct investment in BRICS. A considerable increase has been witnessed in both the inward and outward FDI flows in BRICS countries during the period 1990-2017. In Brazil, the share of services sector in total FDI inflows has declined considerably with a relative increase in primary and secondary sectors, however, services sector continues to attract highest inward FDI. The services sector is the major recipient of inward FDI in Russia also. In India, the share of secondary sector has declined and that of tertiary sector has increased markedly which continues to be the most favoured destination for FDI even today. In China, the share of secondary sector in total inward FDI has been decreasing continuously and that of tertiary sector has been increasing at a remarkable pace. In South Africa, the share of services sector in total inward FDI has outpaced the manufacturing and mining sectors over the last decade. Therefore, it may be concluded from our study that services (tertiary) sector has emerged as a dominant sector in the foreign direct investment scene in the fastest growing BRICS economies.

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