EXTENDING THE INVESTMENT DEVELOPMENT PATH EXPLANATION OF OUTWARD FOREIGN DIRECT INVESTMENT OF DEVELOPING COUNTRIES: THE ROLE OF PRO-MARKET REFORMS AND REGULATORY ESCAPE

Abstract

We study the applicability of the investment development path to the foreign expansion of multinationals from developing countries. The investment development path implicitly argued that as countries develop, their firms would develop sophisticated capabilities and eventually become multinational firms. We propose that in the case of developing countries, two additional factors accelerate the transformation of domestic firms into multinationals. The first one is the push of pro-market reforms, whereby firms are forced to upgrade their capabilities and are able to become multinational firms earlier than expected. The second one is the pull of regulatory escape, whereby firms become multinational companies to avoid punitive regulations in the home country. We illustrate these arguments by analyzing the evolution of Brazilian outward foreign direct investment.

Key words: investment development cycle, outward foreign direct investment, multinational firms, developing countries, Brazil

INTRODUCTION

We study the applicability of the investment development path to the foreign expansion of multinationals from developing countries. The topic of developing-country multinational companies (DMNCs) has re-emerged in recent years with renewed impetus. Although there was a spur of research on these firms in the 1970s and early 1980s (e.g. Lall, 1983; Wells, 1983), less was done until recent times. The renewed interest appears to coincide with the emergence of some of these companies as world leaders in their industries and their undertaking of some bold acquisitions in developed countries that have caught worldwide attention (Economist, 2008; BCG, 2009). In tandem, increasing numbers of researchers from developing and developed countries alike are paying attention to these firms (e.g., see the articles in the special issues of Journal of International Business Studies edited by Luo and Tung, 2007, and of Journal of International Management edited by Aulakh, 2007, and by Gammeltoft, Barnard and Madhok, 2010, the chapters in the books edited by Sauvant, 2008, and Ramamurti and Singh, 2009).

However, these firms are generating a heated debate regarding the merits of analyzing them. On the one hand, some researchers argue that these firms are a new phenomenon that requires new theories because previous theories were based on the analysis of advanced economy multinational companies (AMNC) and therefore the theories are not adequate for explaining the behavior of DMNCs (e.g., Guillen and Garcia-Canal, 2009; Luo and Tung, 2007; Matthews, 2006). On the other hand, other researchers see DMNCs as merely multinational companies and argue that their behavior can be easily explained with existing theories (e.g., Dunning, Kim, and Park, 2008; Dunning and Lundan, 2008); some even argue that no more new theory can be developed to explain MNC behavior (e.g., Buckley, 2002).

We focus on one aspect of their international expansion, their outward foreign direct investment (OFDI), and investigate how the investment development path applies to them. The investment development path was proposed by John Dunning as an explanation of the evolution of the net foreign direct investment in a country (Dunning, 1981; Dunning and Narula, 1996). The idea was that as countries develop, they move from being net recipients of foreign direct investment to becoming net sources of foreign direct investment. This was explained by the changes in the conditions of domestic firms with development. Initially domestic companies did not have the adequate capabilities to compete abroad and thus could not become multinational companies; the country instead received foreign direct investment from other countries in search of low-cost factors of production. However, as the country develops, domestic firms learn to serve more demanding and sophisticated domestic consumers and eventually reach a level of sophistication in their capabilities that enables them to become multinationals and invest abroad. Hence, one would observe the growth of OFDI with the development of the country.

We propose that this argument needs to be modified when analyzing developing countries because two factors result in an acceleration of their OFDI. First, we argue that developing country multinational companies face a push factor in the form of the implementation of pro-market reforms. These induce domestic firms to upgrade their domestic capabilities beyond the level expected from the development of the country, helping them to become multinational companies. Second, we propose that developing country multinational companies have a complementary pull factor in the form of regulatory escape. The existence of overbearing regulations in the home country induces firms to invest in tax havens to escape the regulatory burden. Thus, as a result of these two factors, we will expect higher levels of OFDI in developing countries that their level of development would account for.

We illustrate these ideas by analyzing in detail the evolution of OFDI from Brazil. Brazil is one of the so-called BRIC countries with China, India and Russia that have received increased attention in recent times as they have been heralded as the leading economies in 2050. However, the internationalization of Brazilian companies is a relatively recent phenomenon. Between 2000 and 2003, Brazilian companies invested slightly less than US$ 1 billion per year abroad. From 2004 to 2007, the annual average increased to over US$ 14 billion and, in 2008, it reached the significant amount of US$ 21 billion (BACEN, 2009). The detailed analysis of the evolution of Brazilian OFDI reveals how pro-market reforms facilitated the increase in OFDI and how Brazilian firms have invested heavily in tax havens to escape regulatory burdens.

The rest of the paper is organized as follows. In the next section we review explanations of OFDI. We then analyze the evolution of Brazilian OFDI, first comparing it to other countries and then going deep into its evolution. We conclude with the contribution to the explanations of OFDI.

EXPLANATIONS OF OUTWARD DIRECT INVESTMENT

The Investment Development Path

The idea of an "investment development path" (IDP) was introduced by Dunning in 1981 as a dynamic approach within the OLI paradigm. It suggests an association between a country's level of development (proxied by GDP per capita) and its international investment position (net FDI stock). The basic assumption is that as the country develops, the conditions for domestic and foreign companies change, thus affecting the flows of inward and outward FDI. However, both kinds of FDI affect economic structure as well – there is a dynamic interaction between the two (Buckley; Castro, 1998).

The IDP model consists of five stages. Countries that receive virtually no FDI belong to the first stage (unqualified labor force and low educational level), while those that do receive FDI flows are in the second stage. In the third stage, countries begin to make investment abroad, but still remain net receivers of FDI. In the fourth stage, outward investment is higher than inward investment, and finally, in the more advanced countries, in the fifth stage, on average, FDI outflows are neutralized by incoming investment and these countries tend to reach an unstable equilibrium around zero (Durán; Ubeda, 2001). By reviewing the literature, these authors identified methodological problems in the use of econometric models and indicators. Hence, they propose an alternative method of assessment of the different stages of the IDP.

Developing economies are net receivers of FDI and their location advantages are related to their degree of economic development. However, the outward FDI of these countries shows strong heterogeneity, which suggests that the OFDI stock of developing economies depends to a greater extent on the activity carried out by national governments, and to a lesser extent on the level of economic development and inward FDI. Durán and Ubeda (2001) classify Brazil in the 3rd stage of IDP, in a similar position to Argentina, Mexico, Chile, Portugal and South Africa.

According to Amal (2006), countries like China, India, South Africa, Mexico and Brazil, among others, are the home countries of some leader MNCs from developing countries, and are located in the second stage of IDP. These countries started a process of early internationalization of production, which does not correspond to the steps mentioned by the theory. However, this phenomenon suggests that many companies are developing plans for internationalization of production, without necessarily following all the steps that developed countries' MNCs have done. In Stage 2, as a result of policies adopted by governments in stage 1, countries start to create some specific location advantages. This will mean the beginning of a process of increased

inward FDI, eventually stimulated by the growth of the domestic market in terms of size, or purchasing power. Therefore, the development of local production by foreign companies represents a viable option. This stage is also characterized by the development of some specific ownership advantages by national companies, which should lead such companies to initiate an internationalization process of their activities through FDI in regions or countries of lower stages of development, to find new markets. On the other hand, to increase their strategic assets and ownership advantages, they also try to invest in more developed countries.

Countries ranked in the third stage experience a gradual reduction in the growth rate of FDI flows, and an increase of their outward FDI, which allows the improvement of its international investment position. At this stage, the ownership advantage of domestic companies will change, not so much as a function of government incentives, but partly by their increasing degree of multinationalization and by their competence and ability to manage and coordinate assets located in different countries. This will encourage them to make direct investments, especially in countries that are still in stages 1 and 2, both with the goal of serving those markets, and to build export platforms for other regions (Amal, 2006).

According to our view as to the need to take into account the conditions of the environment in the models of the internationalization process and analyses of multinational firms from developing countries, Turolla, Concer and Monteiro (2010) argue that a set of exogenous factors have not been considered, especially the influence of macroeconomic environment.

Additional Explanation: Access to Advanced Capabilities by Developing Country Multinationals

An additional explanation of the multinationalization of developing country firms is that many of them enter developed countries not to sell there, but to purchase higher quality factors of production and capabilities to complement and upgrade existing operations in the home country. This argument explains some, not all, of the foreign expansions of Asian and Latin American firms (for example, Luo and Tung, 2007; Cuervo-Cazurra, 2007, 2008; Matthews, 2006), which enter developed countries as sources of high quality inputs.

These foreign expansions of developing country firms require a different explanation of the process, because the firms do not move abroad only to sell as traditional models and their extensions argue, but also to buy advanced capabilities. Managers of developing country firms lead their firms to enter developed countries not only to access superior factors of production, but also to access the superior capabilities of specific firms there. As a result, the process of selecting among countries and the process of entering a particular country vary.

First, when assessing the selection of countries where to access advanced capabilities, managers need to be concerned about sophistication distance, the difference in quality or sophistication of factors of production in the host country, rather than psychic distance as in traditional models. Sophistication distance differs from the factor distance because instead of cost, quality is the dimension that matters to managers who are seeking to upgrade the firm's capabilities. Additionally, managers would need to be concerned with the ease of absorption, in terms of the ability of the firm to use the advanced capabilities accessed abroad. What matters to managers is not only whether it is easy to access the advanced capabilities, but also whether the company can use such capabilities to upgrade its own capabilities. As a result, in the selection of countries managers would have to balance sophistication distance with ease of absorption. This balancing may result in firms first entering countries with an easier absorption although not a high sophistication distance and as the firm updates its capabilities and builds its absorptive capacity, entering countries that are at a higher sophistication distance.

Second, advanced capabilities available in other countries are difficult to access and transfer across countries (Kogut; Zander, 1992; Nonaka, 1994). The sequence is driven by an increase in the acquisition of relatively more tacit knowledge, which is also more difficult to transfer across countries, and the subsequent upgrading of capabilities. This would result in a sequence that takes the following form: the firm starts in the home country by purchasing knowledge from foreign providers there; this enables managers to access knowledge that is explicit and can be easily transferred across countries. Once the firm improves its capabilities, it can go to the host country to obtain licenses from providers of knowledge and capabilities there, gaining access to still explicit but more difficult to transfer knowledge. Once managers and employees in the firm have mastered the explicit knowledge, they can obtain the tacit knowledge embedded in the capabilities of firms that have them, establishing tight relationships with or acquiring existing operations in the host country.

PRO-MARKET REFORMS AND OUTWARD FOREIGN DIRECT INVESTMENT: THE EVOLUTION OF BRAZILIAN FDI

We analyze the case of Brazilian OFDI to analyze the applicability of the investment development path as an explanation of OFDI from developing countries. We focus on Brazil because it has been little studied but nevertheless is quickly becoming an important investor.

Brazil in Perspective

In Brazil, the expansion of direct investment flows in the nineties had a strong pressure from trade liberalization and the appreciation of the exchange rate. This is an idiosyncrasy of Brazilian business environment which may be the root of the strong expansion of inward FDI in the second half of the nineties and outward FDI at the end of the 1990s.

After years of state intervention, price controls and limited exposure of firms to global competition, Brazilian industrial sector had proved inefficient. The nineties witnessed a reversal, large but incomplete. In the first half of the decade, the commercial opening of the country increased the exposure of companies to competition, although hasty, without negotiating counterparts with the partners, in order to ensure market access for Brazilian products. Even so, it intensified local competition. Throughout the decade, several factors contributed to enhance the flow of inward FDI: the increased exposure of the economy to international competition was intensified since 1994 by the appreciated exchange rate; the National Privatization Program and other strategies that increased private participation in the provision of public services. And the operational environment was changed in 1994, with the introduction of a modern apparatus of antitrust policies, later supplemented by some industry regulations that contributed to attract investments, as in the telecommunications and energy sectors (Turolla; Concer; Monteiro, 2010)

Under double pressure, from the opening of the economy and unfavorable exchange rates, Brazilian companies found themselves faced with three alternatives: to close businesses, to sell businesses to international groups or to adjust costs to face competition. Several companies have managed to resist, modernizing their businesses and entering foreign markets. Thus, in the 1990s, Brazil has consolidated its position as an important recipient of global FDI. And in the first decade of the 2000s, it has also become a major investor abroad. Through empirical evidence, the authors show that Brazil follows the pattern of Dunning's IDP and is located at stage III.

Brazilian firms are taking a noticeable lead in foreign direct investment. Tables 1 and 2 present the flow and stock of outward direct investment, respectively. The flow of foreign direct investment show high variation from year to year, which biases the comparison across countries.

For example, if we analyze the year 2008, Brazil has higher flows of outward direct investment than India, but this conclusion is reversed if we analyze the year 2007. However, the stock of outward direct investment provides a more stable pattern and comparison. By 2008 Brazil has a larger stock of outward foreign direct investment than the other large developing countries except for Russia, and a much larger stock than any of the large Latin American countries. However, Brazil still has a smaller stock of outward foreign direct investment than any of the large developed countries. The growth in this stock has come in the 21st century, however. As recent as 2000 the stock of outward foreign direct investment from Brazil was a third of what it is by 2008, but this pattern of growth is common across countries.

Table 1. Flow of outward foreign direct investment at current prices and current exchange rates in US$ million

	1970	1975	1980	1985	1990	1995	2000	2005	2006	2007	2008
Brazil	**14**	**108**	**367**	**81**	**625**	**1,096**	**2,282**	**2,517**	**28,202**	**7,067**	**20,457**
China	n.a.	n.a.	n.a.	629	830	2,000	916	12,261	21,160	22,469	52,150
India	0	0	4	3	6	119	509	2,978	14,344	17,281	17,685
Indonesia	n.a.	n.a.	6	33	-11	1,319	150	3,065	2,726	4,675	5,900
Russia	n.a.	n.a.	n.a.	n.a.	n.a.	606	3,177	12,767	23,151	45,916	52,390
Turkey	0	0	0	0	-16	113	870	1,064	924	2,106	2,585
Argentina	2	4	-110	42	35	1,497	901	1,311	2,439	1,504	1,351
Chile	0	0	44	2	8	752	3,987	2,183	2,742	3,009	6,891
Colombia	4	4	106	7	16	256	325	4,662	1,098	913	2,158
Mexico	0	0	3	222	223	-263	363	6,474	5,758	8,256	686
Venezuela	0	0	12	11	375	91	521	1,167	2,076	2,237	2,757
France	365	1,427	3,137	2,226	36,233	15,755	177,449	114,978	121,371	224,652	220,046
Germany	1,070	2,176	4,699	5,655	24,235	39,049	56,557	75,895	127,223	179,547	156,457
Japan	355	1,763	2,385	6,452	48,024	22,630	31,558	45,781	50,266	73,549	128,020
UK	1,678	3,001	7,881	11,068	17,948	43,562	233,371	80,833	86,271	275,482	111,411
USA	7,590	14,244	19,230	13,388	30,982	92,074	142,626	15,369	224,220	378,362	311,796

Source: UNCTAD, FDI Statistics (2010)
Note: Data for Germany before 1990 is only for the former Federal Republic and data for Indonesia before 2003 includes East Timor

Table 2. Stock of outward foreign direct investment at current prices and current exchange rates in US$ million

	1970	1975	1980	1985	1990	1995	2000	2005	2006	2007	2008
Brazil	**n.a.**	**n.a.**	**38,545**	**39,439**	**41,044**	**44,474**	**51,946**	**79,259**	**113,925**	**136,103**	**162,218**
China	n.a.	n.a.	n.a.	900	4,455	17,768	27,768	57,206	73,330	95,799	147,949
India	n.a.	n.a.	78	93	124	495	1,859	10,033	26,799	44,080	61,765
Indonesia	n.a.	n.a.	6	55	86	5,896	6,940	13,932	16,658	21,333	27,233
Russia	n.a.	n.a.	n.a.	n.a.	n.a.	3,346	20,141	146,679	216,488	370,161	202,837
Turkey	n.a.	n.a.	n.a.	1,164	1,157	1,425	3,668	8,315	8,866	12,210	13,865
Argentina	n.a.	n.a.	5,970	5,921	6,057	10,696	21,141	2,334	25,897	27,544	28,749
Chile	n.a.	n.a.	63	116	154	2,774	11,154	21,359	26,596	32,695	31,728
Colombia	n.a.	n.a.	136	301	402	1,027	2,989	8,915	10,013	10,926	13,084
Mexico	n.a.	n.a.	1,632	2,005	2,672	4,181	8,273	29,641	36,447	44,703	45,389
Venezuela	n.a.	n.a.	23	165	1,221	3,427	7,676	9,429	11,524	13,814	16,619
France	n.a.	n.a.	24,910	38,781	112,441	204,431	445,091	868,470	1,044,444	1,291,577	1,396,997
Germany	n.a.	n.a.	43,127	59,909	151,581	268,419	541,861	927,459	1,081,317	1,294,453	1,450,910
Japan	n.a.	n.a.	19,612	43,974	201,441	238,452	278,442	386,581	449,567	542,614	680,331
UK	n.a.	n.a.	80,434	100,313	229,307	304,865	897,845	1,198,637	1,454,904	1,841,018	1,510,593
USA	n.a.	n.a.	215,375	238,369	430,521	699,015	1,316,247	2,241,656	2,477,268	2,916,930	3,162,021

Source: UNCTAD, FDI Statistics (2010)
Note: Data for Germany before 1990 is only for the former Federal Republic and data for Indonesia before 2003 includes East Timor

History of Brazilian OFDI

At the end of Second World War, large European and American companies increased their expansion throughout the world, in search of new markets for their products, in a movement of export substitution, through the establishment of industrial units in other central countries and in some of the most promising peripheral countries (Bresser Pereira, 1978). Until then, companies used to set sales and technical assistance offices in developing countries, to where they exported their products. However, these countries had started import substitution strategies, which hampered those actions.

Another reason to set factories abroad was to take advantage of technological innovations developed in their countries of origin, thus extending the products' life cycle. In view of the difficulties to supply foreign markets with homemade products, due to tariff barriers, multinational companies (MNCs) decided to start manufacture in the consumer markets. In Brazil, there was a convergence of interests between this strategy and the industrial policy of that period, which gave priority to import substitution, which, in the end, resulted in a significant predominance of foreign companies in the most dynamic industrial sectors. Instead of exporting finished products, MNCs started to export raw materials, parts and components for production in Brazil. But there was a good side effect - the country's integration in the production networks of MNCs was relevant to increase exports and for technological learning.

Foreign direct investment contributed significantly to the Brazilian process of economic change and growth, since the mid 60's. Incoming capitals, technology and managerial capacity from industrialized countries benefited the country, increasing productivity and the levels of employment and income, besides the effects of *learning-by-doing* on local suppliers.

As of 1964, and for 20 years, a military government took control, with a nationalistic project of "sovereignty and security" and targeted funds to build a solid industrial park and infrastructure works, reinforcing the import substitution strategy. Some local firms experienced a significant growth, especially those of construction and engineering services (Fleury; Fleury; Reis, 2010). By the end of the 1970's, these companies started to look for contracts abroad, due to the capabilities acquired in the course of huge infrastructure works – hydroelectric and nuclear plants, highways, railways and dams, but with no perspectives ahead (Iglesias; Veiga, 2002).

The internationalization of Brazilian companies is a relatively recent phenomenon. Between 2000 and 2003, Brazilian companies invested slightly less than US$ 1 billion per year abroad. From 2004 to 2007, the annual average increased to over US$ 14 billion and, in 2008, it reached the significant amount of US$ 21 billion (BACEN, 2009).

The internationalization of companies generally starts with exports and is followed by direct investments abroad. While in Brazil the first activity is considered a reason for national pride, the second is still seen, in some political environments, as a way to increase the firms' profits by paying fewer taxes, accessing funds at lower costs and exporting jobs. After 20 years of the big economic changes that followed the commercial opening of the country, this reasoning carries the memory of "market reserve" and "local content" mechanisms, which responded to a political logic, the last one being explicitly prohibited since the Uruguay Round of UNCTAD (Ricupero; Barreto, 2007). Outward FDI also promotes economic growth in emerging countries, according to Chowdhury and Mavrotas (2006) and Dhakal, Rahman and Upadhyaya (2007).

Except for agricultural and mineral commodities' exports, it was in the 1970 decade that Brazilian industrial companies started to consider the international market as an option to drain production surplus or to take advantage of favorable exchange rates for exports. Brazilian FDI was practically null, Petrobras being an exception, through its subsidiary Braspetro, created in

1972, which started investments abroad (oil wells drilling and exploration), by contracts with foreign companies, in order to guarantee sources of oil supply (Cyrino; Tanure, 2009).

As of the 1990 decade, economic liberalization had a fundamental role in stimulating internationalization, by modifying the environmental conditions, thus urging firms to enhance competitiveness, by improving their products and manufacturing processes to compete with foreign firms that already were in Brazil, and many others that were attracted by the new liberal environment. In doing this, they developed capacities, experience and confidence that prepared them for international competition. They rapidly increased their investments abroad. Apparently, FDI helped them accelerate the reverse process (Luo; Tung, 2007).

Several state companies, that had grown and consolidated under government protection, were privatized. In Latin America, Chile was the first country where this happened, in 1975, and later it spread throughout the continent. There was no need for public policies to support internationalization, just the removal of institutional barriers was sufficient to drive companies to search for new markets.

Pro-Market Reforms under the Washington Consensus: Interpretations and Effects

Economic liberalization and privatization were some of the measures suggested by what became known as the "Washington Consensus", which had an enormous influence on Latin American countries. Until then, the big struggle of successive governments was to fight inflation, with poor results.

The term originates from a reform agenda developed during the worst period of the debt crisis in Latin America, published as the book *Toward Renewed Economic Growth in Latin America* (Balassa; Bueno; Kuczynski; Simonsen, 1986). Among the authors were three Latin American economists, and the book defined a policy agenda that was much different from the prevailing thought at that time. Three years later, John Williamson, editor of the proceedings of a conference held to assess the changes that were occurring in the region (*The Progress of Policy Reform in Latin America*), created the term. The agenda supported measures like competitive exchange rates to stimulate export growth, import liberalization, tax reform, generation of domestic savings to finance investment, mainly by tightening fiscal policy, privatization of state-owned enterprises, and reducing government role to providing core public services - basic education, health and sanitation - and a framework for economic activity.

In a short time, the meaning of the term changed from its original sense, which was a list of 10 specific structural reforms that some distinguished specialists gathered in the city of Washington agreed upon as being suitable to a specific region of the world, at a certain period of its history. The expression turned out to be seen as an ideological agenda (neoliberalism) valid for all times, that was being imposed to all countries (Kuczynski; Williamson, 2003).

There is some overlapping between the original meaning of the term and its neoliberal interpretation, regarding aspects as macroeconomic discipline, privatization, market economy and free trade, in which many non-liberals also believe. But it became a cursed term, especially because in the 1990's, some of Washington institutions, like the International Monetary Fund, the World Bank, and also the Inter American Development Bank, insisted heavily on parts of the agenda.

The absence of appropriate institutions became the key element that prevented the success of the transition policies proposed by the Washington Consensus. Liberalization and privatization, without the support of a well-organized market structure, did not result in growth, but instead, a long period of decline (Pereira, 1999).

In the end, criticisms came from everywhere, due to the disappointing results of the 1990 decade in Latin America. At the beginning of that period, it was expected that reforms would make the region grow and allow living standards to start catching up with developed economies, which did not happen. In fact, hyperinflation was defeated in most countries, but growth in the first half of the decade was interrupted by crises all over the continent – Mexico in 1994, then East Asia, Russia, Brazil, Argentina and again Brazil. This was true for most countries, except for Chile, which had the fourth fastest growing economy in the world during the 1990's. Countries encouraged FDI inflows and overvalued currency, turning them vulnerable to short term or volatile capital.

And there was also incompleteness of what was called "first-generation reforms" – low investment, the pension system, liberalization of labor market (formal sector), fiscal reform, poverty reduction. One mentioned mistake was that policies focused on accelerating growth, without any concern for income distribution, employment and equity. Therefore, even hard critics of the Washington Consensus would not blame it for the slow pace of the reforms (Williamson, 2003).

From Hyperinflation to Low Inflation

In Brazil, the military that ruled the country for 20 years could not solve the biggest local problem – inflation. Instead, they worsened it with an increase of expenses, resource misuse, inefficient management and an absolute confusion about the role of the State and that of republican institutions (Melo, 2009). In the 1980 decade, with the aim of equilibrating the balance of payments, a program to promote Brazilian exports was launched, with very bad results, given the low quality of some of the products, among other causes. This contributed to a very negative image of "Made in Brazil" products (Fleury et al., 2010).

The first civilian government after that period came across an inflation rate of 224% in 1984, and at the end of the first year of the new government, it was practically the same. So, in the beginning of 1986, "Plano Cruzado" was created to fight inflation. However, at the end of the period, in 1989, the inflation rate was high again, at 84.32% a month! Governments that succeeded, in spite of different economic plans, could only reduce inflation for short periods. At the end of 1992, it had returned to an annual figure of 1,158%.

Finally, the "Plano Real", in 1994, was able to decrease inflation rates, through the articulated work of several institutions, such as the ministries of Planning and Finance and the Central Bank, along with a set of structural and constitutional reforms, which have not been completely achieved yet (Melo, 2009). Inflation was the most serious economic and political problem to defy, being a real tax on the poor and the mechanism responsible for the terrible income distribution and inequality.

The inflation rate was still huge in 1994 – 1,094%. But it was drastically reduced in 1995 (14.7%). From then on it was kept low –9.3% in 1996; 7.4% in 1997; 1.7% in 1998. But then international crises affected Brazil, as mentioned above.

During the 1990 decade, four long term economic policy and institutional changes were considered responsible for the restructuring of the Brazilian productive sector (Canuto; Rabelo; Silveira, 1997): (1) Commercial and financial liberalization in foreign relations. (2) Economic integration program with Mercosur countries. (3) Implementation of the Plano Real in 1994, which stabilized inflation. (4) Privatization program.

But this assessment was made before the 1999 crisis, which disturbed, once more, the industrial activities, economic stability, balance of payments, salaries and prices and brought back the ubiquitous fear of high inflation.

The Brazilian Exchange Crisis of 1999

A crisis that started in the Asian Tigers almost broke down the economies of Brazil and Argentina, among other countries. But their reaction was quite different. After raising interest rates and using dollar reserves to stop currency rates' fall, Brazil changed its monetary policy, adopting the floating exchange. This measure gave the country more flexibility to face the crisis, although at the cost of very high interest rates which, in turn, made credit expensive, hampered economic growth and increased foreign debt, making it necessary to maintain high interest rates so as to attract more financial resources, within a vicious circle.

In December of 1994, Mexico devaluated its currency in more than 50% and the consequences were disastrous in the following year – inflation reached more than 50%, GDP fell over 5% and the country plunged into a financial crisis. Its dissemination to other countries was known as "tequila effect". When South Korea made a similar option, in 1997, inflation stood below 10% but GDP had a reduction similar to Mexico. Financial crisis was dramatic, followed by the need to promote a complete restructure (Averbug; Giambiagi, 2000).

The Russian crisis, in August of 1998, resulted in the moratorium of public and private obligations, and generated a crisis of trust in global markets, over the credibility of emerging countries, thus conducting to a massive escape of capitals from the Brazilian economy. This fact devastated the government capacity to sustain the existing exchange regime, leading to the January of 1999 crisis.

Academics and economics analysts converge to one vision: the primary cause of the Brazilian crisis was associated to the deterioration of economic foundations, especially the exchange appreciation and the deficits in current transactions, along with the strong increase of the public debt. But it was unleashed by the Russian crisis, which affected the confidence of international investors in emerging markets. However, in contrast with these experiences, when it was time for Brazilian economy to devaluate the Real (R$), the country emerged from the crisis relatively unharmed, with a low inflation rate, a slight increase of GDP and nothing that resembled a financial crisis (Averbug; Giambiagi, 2000).

In the first place, there was not a complete erosion of its reserves. Also, although GDP had increased in 1999, devaluation occurred in a moment of low level of activity, meaning that there was not a favorable environment for firms to raise prices. Third, after devaluation, monetary policy had a significant role in disarming inflationary expectations. And Central Bank raised interest rates to 45% nominal, clearly indicating that the anti-inflationism behavior would be kept, in an "inflation target" regime. After all, Brazil seemed to be finally on its way to a sustainable growth.

DATA ANALYSIS

Brazilian Outward Foreign Direct Investment

The internationalization of Brazilian companies has achieved a broad geographic area. It is basically dominated by the private sector, although state-owned enterprises also play a role, like Petrobras, which has expanded its foreign activities to 15 countries in three continents (Lima; Barros, 2009). Most of the successful state companies are presently private and publicly traded.

In comparison with Chile and Argentina, a strong state in Brazil has produced the most successful outcome in terms of internationalization. It encouraged the creation of national champions that later became important international players. Privatizations, as well as specific incentives for the merger of domestic firms, have been used by the Brazilian state, along with the

power of BNDES, the national development bank, which provides credits for the consolidation and internationalization of Brazilian firms (Finchelstein, 2009).

To get a sense of the long-term evolution of Brazilian FDI, we can look at data from UNCTAD on outward FDI stock and flows. This data appears on Table 3 and Figure 1. The table reveals the slow growth of Brazilian FDI up to the early 2000s, when it shows a remarkable jump, reaching a maximum outward flow in 2006 of US$ 28,202 million. By 2008, outward Brazilian FDI had reached a stock of US$ 162,218 million.

Table 3. Outward foreign direct investments from Brazil

	Outward FDI, flow US$ million	Outward FDI, stock US$ million	Outward flow FDI, % GDP	Outward stock FDI, % GDP
1970	14.00	n.a.	0.03	n.a.
1971	1.00	n.a.	0.00	n.a.
1972	19.00	n.a.	0.03	n.a.
1973	33.10	n.a.	0.04	n.a.
1974	53.80	n.a.	0.05	n.a.
1975	108.00	n.a.	0.08	n.a.
1976	171.90	n.a.	0.11	n.a.
1977	141.90	n.a.	0.08	n.a.
1978	124.20	n.a.	0.06	n.a.
1979	197.60	n.a.	0.09	n.a.
1980	366.50	38544.69	0.16	16.94
1981	207.20	38751.89	0.08	14.43
1982	375.70	39127.59	0.13	13.76
1983	188.30	39315.89	0.09	19.38
1984	42.00	39357.89	0.02	18.83
1985	81.10	39438.99	0.04	17.67
1986	143.60	39582.59	0.05	14.75
1987	138.34	39720.94	0.05	13.50
1988	175.50	39896.44	0.05	12.14
1989	523.10	40419.54	0.12	9.05
1990	624.60	41044.14	0.13	8.58
1991	1015.00	42059.14	0.23	9.45
1992	136.70	42195.84	0.03	9.89
1993	492.30	42688.14	0.10	8.92
1994	689.90	43378.04	0.12	7.27
1995	1095.64	44473.67	0.14	5.78
1996	-469.06	44004.61	-0.06	5.24
1997	1115.56	45120.17	0.13	5.18
1998	2854.01	47974.19	0.34	5.69
1999	1690.41	49664.60	0.29	8.46
2000	2281.59	51946.19	0.35	8.06
2001	-2257.59	49688.60	-0.41	8.97
2002	2482.11	54422.90	0.49	10.75
2003	249.30	54892.00	0.05	9.94
2004	9806.99	69196.20	1.48	10.43
2005	2516.70	79259.00	0.29	8.99
2006	28202.49	113925.00	2.63	10.62
2007	7066.66	136103.10	0.54	10.36
2008	20457.07	162218.40	1.32	10.45

Source: UNCTAD (2010)

Figure 1. Outward foreign direct investments from Brazil in millions of US$

Source: Data from UNCTAD (2010). Note: stock data was not available before 1980.

Figure 2. Outward foreign direct investments from Brazil in relation to GDP

Source: Data from UNCTAD (2010). Note: stock data was not available before 1980.

A more detailed picture is available by using data from the Central Bank of Brazil. Since 2001 the Central Bank has collected detailed information on foreign investments from Brazil. The census is prepared by collecting compulsory electronic forms for Brazilian residents who possess assets in currency, goods or rights abroad over US$ 100,000.This short series provides a clearer and somewhat surprising picture of Brazilian outward FDI. Although there are differences with the data collected by UNCTAD, these can be attributed to differences in methodology and therefore we will not establish comparison among these time series. Table 4 presents the distribution of all Brazilian stocks of foreign investments by their type, with foreign direct investment, or investments in a foreign firm in which the investor controls more than 10% of the capital, being only part of these. By 2008, Brazil has a total stock of foreign investment of US$170 billion, of which foreign direct investment represented 72% of the total at US$122 billion. However, of these US$80 billion were direct investments, whereas US$41 billion were intercompany loans. Foreign portfolio investments, or investments in a foreign company in which the investor controls less than 10% of the capital, represented 10 of total foreign investments at US$16 billion, with a sizeable part of this being investments in stock at US$4 billion, but representing only 2% of total foreign Brazilian investments. Over time, the stock of foreign direct investment has increased significantly, more than doubling from US$49 billion in 2001 to US$122 billion in 2008. Although foreign direct investment has represented on average a little less than three quarters of total direct investment in this period, intercompany loans have increased in importance from 10% of total foreign investments in 2001 to 25% in 2008, while direct investment has decreased in importance from 62% of total foreign investments in 2001 to 47% in 2008.

Table 4. Outward stocks of investments from Brazil by type of investment in US$ million

	2001	2002	2003	2004	2005	2006	2007	2008
TOTAL	68,598	72,325	82,692	93,243	111,741	152,214	155,176	170,397
Foreign Direct Investment	49,689	54,423	54,892	69,196	79,259	114,175	103,923	122,140
FDI. Direct investment	42,584	43,397	44,769	54,027	65,418	97,715	75,376	80,226
FDI. Intercompany loans	7,104	11,026	10,123	15,169	13,842	16,460	28,547	41,914
Foreign Portfolio Investment	5,163	4,449	5,946	8,224	9,586	14,429	22,124	16,283
FPI. Stock	2,517	2,317	2,502	2,258	2,725	2,811	3,364	4,025
FPI. BDR	483	71	94	94	84	943	3,280	803
FPI. Long-term debt	577	941	1,491	2,899	3,602	6,185	6,792	6,496
FPI. Short-term debt	1,585	1,120	1,859	2,973	3,176	4,490	8,688	4,959
Derivatives	42	105	81	109	119	113	142	609
Financing	155	313	186	68	98	70	99	123
Loans	696	537	687	631	726	562	785	658
Leasing	1	3	0	0	1	1	n.a.	n.a.
Deposits	9,441	7,890	16,412	10,418	17,077	17,200	22,487	24,051
Other investments	3,411	4,605	4,488	4,597	4,875	5,664	5,616	6,533

Source: Central Bank of Brazil (BACEN).

Note: BACEN did not collect detailed information on FDI before 2001.

Focusing our attention on foreign direct investment, which is the topic of this paper, we now look at its distribution across countries. Table 5 presents the distribution by selected countries, and also by the five regions according to the geographic classification of the countries by the United Nations: Americas, Europe, Africa, Asia, and Oceania. The analysis of the destination of foreign direct investment by region reveals a high regional concentration. Most of the outward stock of foreign direct investment is concentrated in the Americas, which representing 70% of all foreign investment from Brazil in 2008, followed by Europe, which represents 29%, while all Asia, Africa and Oceania account for the remaining 1%. This

concentration in the Americas has diminished over time, from representing 86% in 2001 to 70% in 2008, while Europe has gained importance, moving from representing 12% in 2001 to representing 29% in 2008. Other continents have never represented more than 1% in the period.

Within the Americas, the surprise comes in terms of the specific countries in which Brazilian firms have invested. The largest recipient of Brazilian FDI are not the United States, Canada or Mexico, which are the largest economies of the Americas besides Brazil, or Argentina, Venezuela or Colombia, which are large neighboring countries, but Cayman Islands, British Virgin Islands, and the Bahamas, countries that traditionally have been viewed as tax havens because of their low taxes and regulations and high protection of privacy. In fact, Cayman Islands represent a hefty 25% of the direct investment and an incredible 93% of the intercompany loans in the Americas. British Virgin Islands and Bahamas represent 19 and 17% of direct investment but less than 2% of intercompany loans in the Americas. The United States, which is the leading economy in the continent and investments in which have generated much attention of the might of Brazilian multinationals represents 16% of direct investment and 3% of intercompany loans in the Americas. Surprisingly again, Panama, which has also been considered a tax haven, appears as the fifth largest recipient of direct investment with almost 7% of direct investment, followed by neighboring Argentina with 6% and Uruguay with 4%, then another tax haven of Netherlands Antilles with almost 2% of direct investment. Other countries represent less than 1% of Brazilian direct investment abroad. This concentration of Brazilian outward foreign direct investment in countries considered tax havens is surprising, given that most people would tend to assume that Brazilian firms invest in either the United States because of the importance of the market or Argentina because of the proximity. However, it is not that surprising once the characteristics of Brazil are understood, especially the high levels of regulations and taxes imposed on businesses. In fact, the *Doing Business 2010 Report* of the World Bank places Brazil as 129th in the world. Thus, moving to tax havens is a normal outcome of operating in a country with high levels of government controls. Nevertheless, such move does not mean that Brazilian companies are escaping their tax obligations, but is may also reflect the ease that locating in these countries can provide Brazilian multinationals to later undertake actual investments abroad.

In Europe, in 2008 the presence of Brazilian multinationals is much more broadly distributed among countries, with much less concentration on tax havens. Specifically, it is concentrated on Denmark and Spain with 21% of all European direct investments each, followed Luxembourg with 15%, Netherlands with 10%, Hungary with 7%, Austria and the United Kingdom with 6% each, and Portugal with 5%. Other countries have less than 1.5% of the European investment in each. Although intercompany loans are concentrated in France, Ireland and Austria, their monetary value is small in comparison to the direct investment.

In other regions of the world, the presence of Brazilian multinationals is limited. In 2008, in Asia, the main destinations are been China and Japan, in Africa it is Angola, a former Portuguese colony, and in Oceania it is Niue Island. However, the stock of outward FDI in these three regions together is less than US$200 million, which pales in comparison to the stock on the Americas at US$ 56 billion or Europe at US$23 billion.

Looking at the evolution over time, the most noticeable differences among countries with large Brazilian investments are the increase in outward FDI in the United States, which moved from US$1.4 billion in 2001 to US$9.1 billion in 2008, Spain, which increased from US$1.6 billion to US$5.0 billion in this period, and Denmark, which changed from US$ 0.01 billion to US$5.0 billion.

Table 5. Outward stocks of FDI from Brazil in US$ million (selected destinations)

	Foreign Direct Investment								Intercompany loans							
	2001	2002	2003	2004	2005	2006	2007	2008	2001	2002	2003	2004	2005	2006	2007	2008
Total Americas	36,938	36,586	36,491	36,271	40,861	67,605	52,526	56,295	6,029	10,200	9,688	14,818	13,519	15,906	27,673	40,633
Americas as % of world	86.74	84.31	81.51	67.13	62.46	69.19	69.68	70.17	84.86	92.51	95.70	97.69	97.67	96.63	96.94	96.94
Argentina	1,625	1,503	1,549	1,722	2,068	2,136	2,360	3,376	164	121	100	77	72	29	136	145
Bahamas	5,954	6,958	6,565	7,825	7,449	9,259	9,341	9,532	216	326	360	409	377	101	288	62
Bermuda	990	1,103	593	397	690	15,061	599	234	3	5	7	39	7	17	59	14
British Virgin Islands	7,109	5,416	6,314	6,254	7,333	10,345	11,245	10,685	725	436	396	398	332	392	631	495
Canada	405	222	22	23	41	11	16	13	31	46	33	20	17	2	5	
Cayman Islands	14,785	16,465	15,097	13,930	15,113	20,284	16,431	14,124	3,814	7,696	7,151	12,389	11,387	14,539	25,212	37,981
Colombia	130	26	42	42	30	47	178	298	1	2	5	4	3	24	25	33
Mexico	52	99	50	137	141	150	175	249	24	9	21	24	17	10	372	33
Panama	674	681	478	334	423	476	1,185	3,727	289	280	301	74	100	95	92	23
United States	1,401	1,830	2,100	2,552	4,163	3,942	6,025	9,167	134	280	193	264	176	286	411	1,388
Uruguay	3,121	1,547	2,810	1,657	1,748	1,743	1,878	2,443	482	693	831	676	621	121	152	75
Venezuela	27	19	13	51	135	104	218	282	13	16	6	13	14	2	5	14
Total Europe	5,110	6,524	8,013	17,473	24,209	29,890	22,594	23,734	1,038	776	425	326	316	550	858	1,192
Europe as % of world	12.00	15.03	17.90	32.34	37.01	30.59	29.97	29.58	14.62	7.04	4.20	2.15	2.28	3.34	3.00	2.84
Austria	21	106	324	397	659	3,819	1,794	1,463							9	201
Denmark	16	8	10	6,460	9,466	10,361	7,276	5,093	0	0	0			14	14	10
France	46	59	85	107	94	95	156	204	61	110	101	53	94	91	124	280
Hungary		13	112	405	840	1,134	901	1,827		0	0				0	
Ireland	0	5	55	55	55	88	125		84	176	55	60	0			293
Luxembourg	584	402	2,055	3,114	3,512	3,918	3,043	3,577	0	7	7	17	76	98	27	40
Netherlands	208	247	599	1,095	2,936	3,195	2,160	2,380	372	127	143	83	15	164	24	86
Portugal	697	1,186	1,066	945	864	975	1,207	1,128	37	15	13	22	11	10	145	10
Spain	1,657	2,953	1,775	2,934	3,324	4,221	4,083	5,055	16	12	19	41	15	30	128	152
United Kingdom	225	91	420	450	815	875	805	1,341	110	33	19	21	61	52	40	12
Total Asia	105	106	132	150	181	190	170	119	26	35	2	1	1	2	16	25
Asia as % of world	0.25	0.24	0.29	0.28	0.28	0.19	0.23	0.15	0.37	0.31	0.02	0.00	0.01	0.01	0.06	0.06
China	15	13	15	28	76	93	83	48	0	1	0	0	1	2	2	9
Japan	46	52	76	103	100	92	41	42	26	30	0	0				0
Total Africa	423	152	104	122	140	25	82	73	9	12	4	21	2	2	0	55
Africa as% of world	0.99	0.35	0.23	0.23	0.21	0.03	0.11	0.09	0.13	0.11	0.04	0.14	0.02	0.01	0.00	0.13
Angola	265	18	22	24	17	20	73	58	9	12	3	10	1	1		49
Total Oceania	7	28	29	12	27	5	5	6	2	3	3	3	2	0	0	10
Oceania as % of world	0.02	0.07	0.06	0.02	0.04	0.00	0.01	0.01	0.03	0.03	0.03	0.02	0.02	0.00	0.00	0.02
Niue Island		21	20	3	23	4	4	3								

Source: Central Bank of Brazil (BACEN).
Note: BACEN did not collect detailed information on FDI before 2001.

Surprises in OFDI Data: The Role of Tax Havens

The distribution of outward stocks of foreign direct investment by industry reveals a surprising concentration of these in two sectors, finance and insurance, and services to companies. Table 6 provides the summary of direct investment by broad sectors of activity. We grouped these together into related categories by their description in the database. Different from the previous chart, we do not have data on intercompany loans, but these are likely to be concentrated on the finance and insurance and services to companies sectors because 93% of them are going to the Cayman Islands. By 2008 the leading sector of activity was finance and insurance, which represented 50% of all outward stocks of foreign direct investment at US$40 billion, followed by services to companies, which represented 33% at US$26 billion. Besides these sectors, the investments are fairly distributed across industries, with none representing more than 2.5% of the total investments. Such concentration has been remarkably stable over time, with these two sectors accounting for over 80% of all investments.

Table 6. Outward stocks of foreign direct investments from Brazil by industry in US$ million

	2001	2002	2003	2004	2005	2006	2007	2008
Total	42,584	43,397	44,769	54,027	65,418	97,715	75,376	80,226
Agriculture, forestry and fishery	112	37	59	245	65	75	92	93
Oil and Gas	1,556	78	182	566	2,808	2,319	1,431	1,324
Mining	3	4	18	228	550	1	201	155
Food, beverage and tobacco	305	146	230	230	533	489	585	822
Textiles, clothing and leather goods	37	28	41	46	61	451	281	218
Wood and paper	123	33	39	28	36	28	8	15
Printing	0	0	0	3	29	4	3	15
Chemicals and refining	703	792	378	237	298	835	246	461
Non-metallic product	440	270	23	18	23	24	1,063	1,225
Metallurgy	6	6	6	8	7	190	717	750
Metallic products	118	145	152	468	478	668	197	132
Machinery	242	180	223	153	236	336	263	198
Electronics and instruments	3	22	16	6	14	12	1	1
Vehicles	193	111	83	69	93	108	345	590
Other industries	0	0	0	0	0	0	1,022	1,801
Utilities	44	129	32	33	35	45	889	933
Construction	1,229	1,504	695	544	568	1,088	670	509
Retailing	1,786	1,845	1,908	2,342	2,937	2,819	2,865	1,780
Hotels and restaurants	10	7	14	14	18	14	7	13
Transportation	285	188	154	255	276	102	247	160
Telecom	32	67	53	165	200	51	150	145
Finance and insurance	20,736	23,597	22,355	28,041	32,153	37,030	43,337	40,321
Rental	114	120	110	110	143	193	369	529
Services to companies	14,410	14,009	17,872	20,057	23,681	50,680	19,163	26,799
Education, health and entertainment	96	79	127	159	174	153	1,222	1,239

Source: Central Bank of Brazil (BACEN).
Note: BACEN did not collect detailed information on FDI before 2001

CONCLUSIONS

The liberalization of trade and investment that have accompanied economic globalization, along with the advances in information and communication technologies, and, in particular, the big economic reforms in Brazil, following the Washington Consensus, were the main causes of the growth in the number of multinationals, and not merely the country's growth. Firms need to

be exposed to foreign competition to move from being exporters to becoming MNCs. The opening of the Brazilian economy provided the adequate environment for this transformation.

After many years of state intervention, price controls and limited exposure to global competition of enterprises, the 1990 decade saw a huge reversal of this model. The opening of the economy increased the exposure of companies to competition, and throughout the decade, other factors contributed, especially the National Privatization Program. Under a double pressure of economic opening and unfavorable exchange rate, many Brazilian companies have closed, or were sold to international groups. A small group persisted, set costs to face the competition, improved operations and went abroad. In the 2000 decade, this outward movement experienced a strong increase.

According to Dunning's Investment Development Path, Brazil has been ranked in the second stage. But authors like Durán and Ubeda (2001) and Turolla, Concer and Monteiro (2010), who found some methodological problems in the assessment of IDP, rank Brazil in the third stage, where several companies are beginning to make investments abroad, but the country still remains a net receiver of FDI.

However, the arguments of the investment development path can be complemented with the two ideas that the analysis of Brazilian OFDI illustrates: the role of pro-market reforms as a push factor and the role of regulatory escape to tax havens as a pull factor.

The implementation of pro-market reforms pushed companies to upgrade their capabilities beyond the level expected from the development of the country, which helped them become multinational companies earlier than expected. The pull factor of regulatory escape explains the multinational expansion in order to avoid punitive regulations in the home country. As a result of these two factors, we observe higher levels of OFDI in developing countries than their level of development would account for. But the big challenge still is to climb to the next stages of the IDP.

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