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FOREIGN DIRECT INVESTMENT (FDI) AND INVESTMENT CLIMATE: A STUDY OF BRICS ECONOMIES

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Abstract

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. Investment among the BRICS (Brazil, Russia, India, China and South Africa) countries has shown progressive growth over the past decade {1}, but still it needs to improve them. The main objective of this paper is to understand the dynamics of FDI flows and investment climate in BRICS countries. Investment climate means sound infrastructure, Governance, Institutional strength. All these factors contribute to the investment climate in any country. Any investors look for all these above said factor and assess their future returns. Therefore the main outline of this article is to assess different factors which influence the inflow of FDI. For this purpose various competitive index such as World Bank Ease of Ding Business, World Economic Forum Global Competitiveness Index (GCI), World Bank World Wide Governance Index (WGI) have been analyzed. Finally the paper concludes that a sound investment climate is required to attract FDI inflows in BRICS countries.

Key words: Foreign Direct Investment, Investment Climate, BRICS.

INTRODUCTION

FDI & INVESTMENT CLIMATE IN BRICS COUNTIRES

India's sizeable and rapidly growing domestic market, well-regulated and growing financial markets, large English speaking population and its suitable democratic government make it attractive place for investment. However, India underperforms its vast potentials. Major areas of concern include rampant corruption, complex and lengthy investment and business approval processes, antiquated land acquisition and labor laws, and poor contract enforcement. Furthermore, India's GDP growth slow-down in the past year, its large fiscal and current account deficits [{2}], and persistent inflation raise concerns about its economic outlook.

Insert fig. 1 Macro Economic Indicators (India)

In recent months, the government has taken some steps to ease Foreign Direct Investment (FDI) restrictions in certain sectors and to improve corporate governance laws. However, further policy reforms have been hung up in a stalemated parliament giving rise to uncertainty about the pace and efficacy of additional measures for improving the investment climate [{3}].

Insert fig. 2 FDI Inflows (% of GDP) BRICS

China's sustained high economic growth rate and the expansion of its domestic market help explain its attractiveness as an FDI destination. However, foreign investors often temper their optimism regarding potential investment returns with uncertainty about China's willingness to offer a level playing field vis-à-vis domestic competitors. In addition, foreign investors report a range of challenges related to China's current investment climate. These include industrial policies that protect and promote state-owned and other domestic firms, equity caps and other restrictions on foreign ownership in many industries, weak intellectual property rights (IPR) protection, a lack of transparency, corruption, and an unreliable legal system. China has a legal and regulatory framework that provides the government with discretion to promote investment in specific regions or industries it wishes to develop, and to restrict foreign investment deemed not to be in its national interest or that might compete with state-sanctioned monopolies or other favored domestic firms. Foreign investors report that many regulations contain undefined key terms and standards, and that regulations are often applied in an inconsistent manner by different regulatory entities and localities. Potential investment restrictions in China are thus much broader than those of many developed countries, including the United States.

Brazil is open to and encourages foreign direct investment. New foreign direct investment (FDI) into Brazil reached approximately USD 65 billion in 2012 [4] and, according to the United Nations Conference on Trade and Development (UNCTAD) World Investment Report, Brazil is the fifth-most attractive country for FDI for the period of 2012-2013 and is consistently the largest FDI recipient in Latin America, typically receiving close to half of all South America's incoming FDI. The United States is a major foreign investor in Brazil; according to the Central Bank of Brazil, the United States had the highest stock of FDI in Brazil as of 2010, with US$104 billion. While Brazil is generally considered a friendly environment for foreign investment, complex tax and regulatory requirements exist. In most cases, these impediments apply without discrimination to both foreign and domestic firms. The Government of Brazil (GOB) generally makes no distinction between foreign and national capital in cases of direct investment.

Russia continues to promote the use of high-tech parks, special economic zones and industrial clusters which offer additional tax and infrastructure incentives to attract investment. Russia's continued engagement in the accession process to the Organization for Economic Cooperation and Development (OECD) could also lead to greater market access for foreign investors. Despite these positive changes, investing in the Russian market still requires that firms navigate a complicated and fluid set of challenges ranging from complex and burdensome regulatory processes to corruption that marks both political and judicial structures.

The government of South Africa is open to green field foreign investment as a means to drive economic growth, improve international competitiveness, and access foreign export markets. Merger and acquisition activity is more sensitive and requires more advance work. Virtually all business sectors are open to foreign investment. Certain sectors require government approval for foreign participation, including energy, mining, banking, insurance, and defense. While the South African government supports investment in principle, investors and market commentators were concerned its commitment to assist foreign investors was insufficient in practice. Some of their concerns included a belief that the national-level government lacked a sense of urgency when it came to supporting investment deals. Several investors reported trouble accessing senior decision makers. Additionally, South Africa has begun scrutinizing merger- and acquisition-related foreign direct investment for its impact on jobs and local industry. Private sector representatives and other interested parties were concerned about politicization of South Africa’s posture towards this type of investment.al is required to invest, and there are few restrictions on the form or extent of foreign investment.

OBJECTIVES

1. The main objective of the research is to understand the investment climate in BRICS countries and its impact on FDI Inflows.

2. To access the impact of Ease of Doing Business (EDB), Global Competiveness Index (GCI) and World Wide Governance Index (WGI) with respect to BRICS countries.

REVIEW OF LITERATURE

There are a couple of empirical studies focusing on the link between FDI and “doing business” indicators. Piwonski (2010) shows that by increasing their country’s Ease of Doing Business rank one level, a government can bring in over $44 million USD as FDI. Morris and Aziz (2011) study the relationship between factors that affect conducting business and the inflow of FDI to Sub-Saharan Africa and Asian countries (57 countries in total). They focus on correlation coefficients between different variables between 2000 and 2005, but they do not include any regression analysis. They find that two indicators, “registering property” and “trading across borders,” were related to FDI inflows. Their paper provides empirical support to the hypothesis that FDI is related to business climate.

Nnadozie and Njuguna (2011) investigate the link between investment climate, in particular the prevailing business regulations, and FDI in the Africa region only. After running regressions which use business regulations as one of the independent variables, they find that business rules and regulations are important for FDI. The initial results indicate that countries which have better “doing business” indicators tend to attract more FDI inflows. The improvement in “doing business” indicators in developing countries can have a partial explanatory power in determining higher FDI flows to these countries.

Hadjila kraifa & luliana mates (2010) in their article anayse the linkage among business climate, political risk and foreign direct investments for a data sample of 33 developing countries over the period 1996-2008. For this purpose they used two main models: a fixed model and a dynamic panel model using the Arellano – Bond GMM estimators. The fixed effect model highlight the importance of the political risk and the soundness of the government track record (the role of the trade openness and GNI per capita) while the business conditions do not significantly associated to FDI inflows. But the dynamic panel model the result are more convincing regarding the business climate in the sense that favorable business condition are significant and positively associated with FDI inflow.

Tajul Ariffin Masrun & Hussin Abdullah (2010) attempts to investigate the impact of institutional on inflows of FDI into ASEAN, they conduct a regression analysis. They have used two motivation of FDI inflows, while are Market -Seeking and Efficiency Seeking. The result support the idea that the institutional quality could be the solution for the slowing pattern of FDI inflows into the region.

Alemu Aye Mengistu & Bishnu kumar Adhikari in their article examines the effect of six components of good governance on FDI inflows in 15 Asian economies for the period 1996-2007 using a fixed effect model for panel data with heteroskedasticity correct standard errors. The empirical result reveal that among the six indicators of good governance defined by Kaufmann et. al.(1999,2009), political stability and absence of violence, rule of law, the control of corruption and government effectiveness are found to be robust determinants in attracting a high level of FDI. The remaining two elements of good governance (Voice and Accountability and regulatory quality), however do not show significant influence to FDI inflows.

EASE OF DOING BUSINESS (BRICS)

Since 2003 the International Finance Corporation (IFC) of the World Bank has published the Doing Business Report (DB) to describe the overall business environment in various countries and to provide policy makers with a basis for international comparisons of their regulatory regimes [5]. Data are gathered through interviews with businesses operating in the economies being surveyed, thereby capturing the experience from the user's side. Ease of doing business ranks economies with first place being the best. A high ranking (a low numerical rank) means that the regulatory environment is conducive to business operation. The index averages

the country's percentile rankings on 10 topics covered in the World Bank's Doing Business. The ranking on each topic is the simple average of the percentile rankings on its component indicators. The index in Doing Business 2013 includes : starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts and resolving insolvency.
The BRICS growing importance for the world economy is reflected by various economic and demographic indicators. These include their increasing share in world GDP; share in world trade; trade openness and increasing foreign exchange reserves; and their foreign direct investment (FDI) inflows and outflows. The BRICS countries are gearing themselves towards preparing for a greater role in the international market. The drive is being supported by a number of initiatives in different BRICS countries to increase their global competitiveness, and to facilitate ease of doing business and promoting increased movement of people.

If look at the overall performance of BRICS countries in Ease of Doing Business, South Africa tops the ranks for ease of doing business of all the BRICS (Brazil, Russia, India, China and South Africa) nations. South Africa moved up two spots to rank 39th out of 185 countries in the World Bank and International Finance Corporation's Doing Business 2013 report. South Africa fell between developed countries such as France (34) and Spain (38), and above major developing economies such as, China (91), Russia (112), Brazil (130) and India (132).

Insert Fig. 3. Ease of Doing Business (BRICS)

The report placed South Africa tenth for its protection of investors, the best of all African countries, and it recorded significant improvements in the areas of trading across borders and enforcing contracts.

China was ranked 91st in ease of doing business, which pointed to the difficulty in paying taxes and the long waits for construction permits as unfavorable business conditions in the world’s second largest economy. If look at the overall trend, China is not disturbed by the financial crisis of 2008, it has maintained its rank, though it has severely effected by the global slowdown in the year 2012.

Russia was ranked 112th out of 185 countries in the Ease of Doing Business rating. Among the other BRICS nations in the rating, Russia is right in the middle, below South Africa and China and above Brazil and India. Since last year Russia has climbed up by 6 positions. This improvement in the country's rating resulted from a number of reforms implemented in Russia: made getting electricity less costly by revising the tariffs to connection, eliminating of requirement to obtain cadastral passport on land plots, filing a commercial case easier by introducing an electronic case filing system and made trading across borders easier by reducing the number of documents needed for each export/ import transaction and lowering the associated cost.

India continues to be a tough place for doing business even as the country has improved regulator processes for starting enterprises and trading across borders, according to World Bank and IFC. In terms of ease of doing business, India is ranked 132nd among 185 countries. The nation's position for 2013 is unchanged from 2012. Only on two fronts -- dealing with construction permits and registering property -- India has improved its position in 2013 report compared to 2012. The ranking has remained unchanged in terms of getting credit and enforcing contracts.

Brazil refers to a plethora of factors such as high energy costs, poor infrastructure facilities, high labor costs, high rate of taxation, excessive bureaucratic delays and poor infrastructure facilities that have the effect of significantly increasing the cost of doing business in Brazil. In its annual Doing Business Survey 2013, The World Bank ranks Brazil 130 among 185 countries in terms of the ease of conducting business. The excessive delays caused by red-tape and bureaucracy act as further deterrents for prospective investors. The 2013 Doing Business Survey also ranks Brazil as 130 and 139 in the number of days to start a business and the number of procedures to start a business respectively.

GLOBAL COMPETITIVENESS INDEX (BRICS)

The WEF defines competitiveness as “the set of institutions, policies, and factors that determine the level of productivity of a country". The global competitiveness index uses this definition to establish a quantitative tool to help policymakers benchmark and measure the competitiveness of a given country.

The GCI is based on 12 pillars of competitiveness that are divided into 3 pillar groups: Basic Requirements (Institutions, Infrastructure, Macroeconomic stability, Health and primary education), Efficiency Enhancers (Higher education and training, Goods market efficiency, Labor market efficiency, Financial market sophistication, Technological readiness, Market size), and Innovation and Sophistication Factors (Business sophistication, Innovation). Each pillar is made up of indicators that come from either 'hard data,' from major international sources, or 'soft data,' from the WEF conducted Executive Opinion Survey. These raw data indicators for a given country are scored on a scale of 1 to 7, where 7 is the best score. The pillars are then given a score by averaging the indicator scores under that pillar. Similarly, the scores of the pillar groups are derived by averaging the scores of the pillars within that group. When creating the overall score for each country, weighting schemes are applied, based on GDP per capita. Countries are grouped into three Stages of Development based on their GDP per capita. Least developed countries are thought to be factor driven, middle income countries are efficiency driven and developed countries are deemed innovation driven. As a country develops, less weight is put on the Basic Requirements and more is placed on Efficiency Enhancers and Innovation and Sophistication. To ensure that the changing weights do not cause jumps in the GCI scores over time, there are transition GDP per capita ranges. These ranges apply a linear method to the transition stages that allow score changes to be smooth as countries enter different stages of development. Among the five BRICS, the People's Republic of China (29th) continues to lead the group, followed by South Africa (53rd), Brazil (56th) India (60th) and Russia (64th). Only Russia improves its ranking, climbing three places, while Brazil and India drops its places. In case of India most problematic factor include: Inadequate Infrastructure, inefficiency of government bureaucracy, corruption, Faulty Tax regulation and policy instability.

Insert fig. 4 Global Competitiveness Index (BRICS)

WORLD WIDE GOVERNANCE INDICATORS (CORRUPTION INDEX)

The Worldwide Governance Indicators (WGI) are a long-standing research project to develop cross-country indicators of governance. The WGI consist of six composite indicators of broad dimensions of governance covering over 200 countries since 1996: namely, i) Voice and Accountability, ii) Political Stability and Absence of Violence, iii) Government Effectiveness,

iv) Regulatory Quality, v) Rule of Law, and vi) Control of Corruption. In this article special focus will be on corruption index. High Corruption leads to Increase in the cost of production and reduce the credit worthiness of the country) The world Economic Forum estimates that corruption adds up to 10% to the total cost of doing business globally and up to 25% to the cost of procurement contracts in developing countries. Corruption also raises the cost of capital by worsening a country's risk rating. Maplecroft global risk analytics firm**:** India ranked 69th most graft-prone nation out of 197 countries, calling it an extremely risky place to do business. Transparency International's Corruption perception Index in 2012 ranked India 94 out of 176 nations, below neighbors Sri lanka & China.

Insert fig. 5 World Wide Governance Index (BRICS)

WORLD ECONOMIC FORUM: QUALITY OF INFRASTRUCTURE (BRICS)

Brazil's overall quality of infrastructure, at 107 out of 144 countries, ranks well below those of fellow BRIC countries, India at 87 and China at 69, and nearly on par with that of Russia at 101 based on the World Economic Forum's assessment. Overall results can mask large variations in the quality of different types of infrastructure. While Brazil fares relatively well on the quality of electricity supply despite the spate of recent outages, manufacturers complain about Brazil having the world's fourth highest utility rates. The chart below presents the infrastructure quality rankings for the BRIC countries and a selection of OECD countries for comparison purposes.

Insert fig. 6 Quality of Infrastructure (BRICS)

CONCLUSION

The BRICS countries are gearing themselves towards preparing for a greater role in the international market. The drive is being supported by a number of initiatives in different BRICS countries to increase their global competitiveness, and to facilitate Investment climate. For example, to facilitate ease of doing business in India, the government has introduced many initiatives. These include addressing the structural Factors in power sector and natural resources.(mining , gas Etc.), Land Acquisition bill, Progress on goods and service tax (GST), Easing of labour regulation in the formal sector, Improvement in the growth of core sector (coal, electricity- particularly hydro power, steel) Faster clearance of projects by cabinet commit. Similarly Brazil also improved its position on Power supply and other competitive aspect. China achieved highest fdi inflows among BRICS countries due to its focus on Infrastructure development. Both Russia and South Africa trying to increase their FDI flows on natural resources and giving proper condition to the investors. Finally one can conclude that there are many conditions that have to be put in place to attract FDI . It is important to ensure an attractive investment climate, consistent macroeconomic policies, good governance, economic stability, guarantee of property rights, rule of law and absence of corruption are among the conditions required to attract FDI. Consistency and predictability in economic policies and political stability are preconditions to attract FDI.

END NOTES

{1} Global Investment Trends Monitor (UNCTAD), “The rise of BRICS FDI and Africa”, special edition, 25th March 2013.

{2} -5.1 current account balance as % of GDP, Economic Times Pp.16, August 1, 2013

{3} U.S Department of state, “Investment Climate statement- India”, 2013.

{4}United Nations Conference on Trade and Development (UNCTAD), World Investment Report, 2013.

{5} Mehrdad Roham, Anait R. Gabrielyan & Norman P. Archer, “Understanding Business Regulations And Their Enforcement Around The World: Enriching Ease Of Doing Business Indicators”, Mcmaster University, Canada, September 1, 2010.

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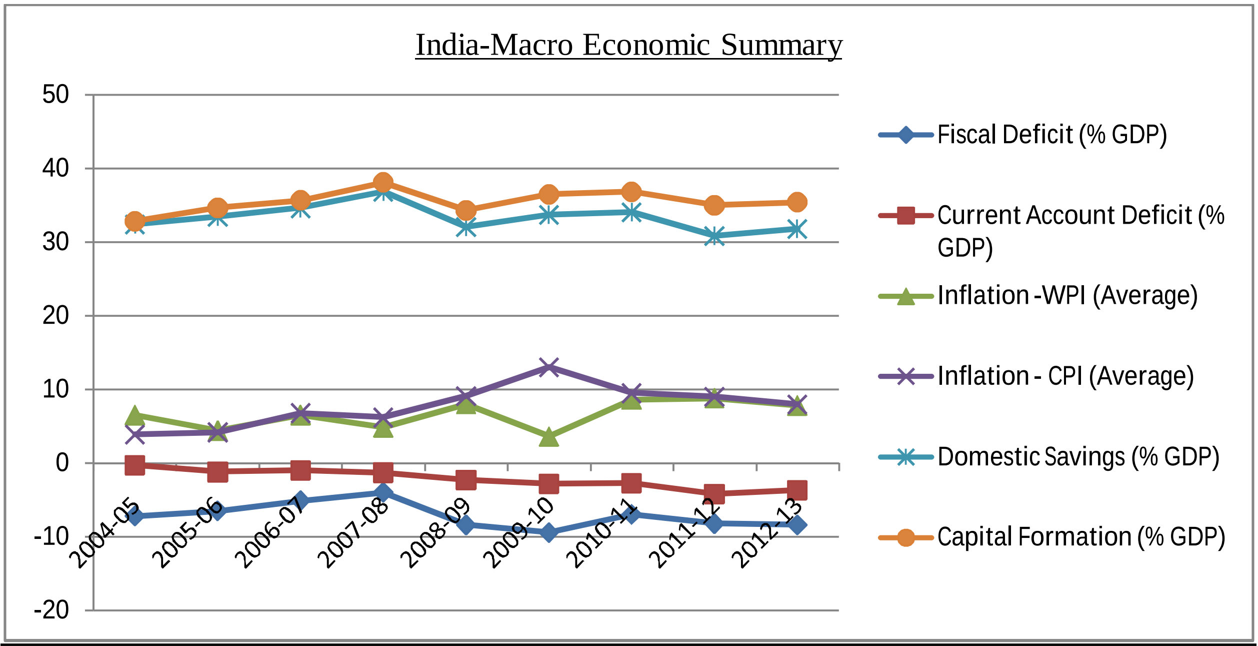
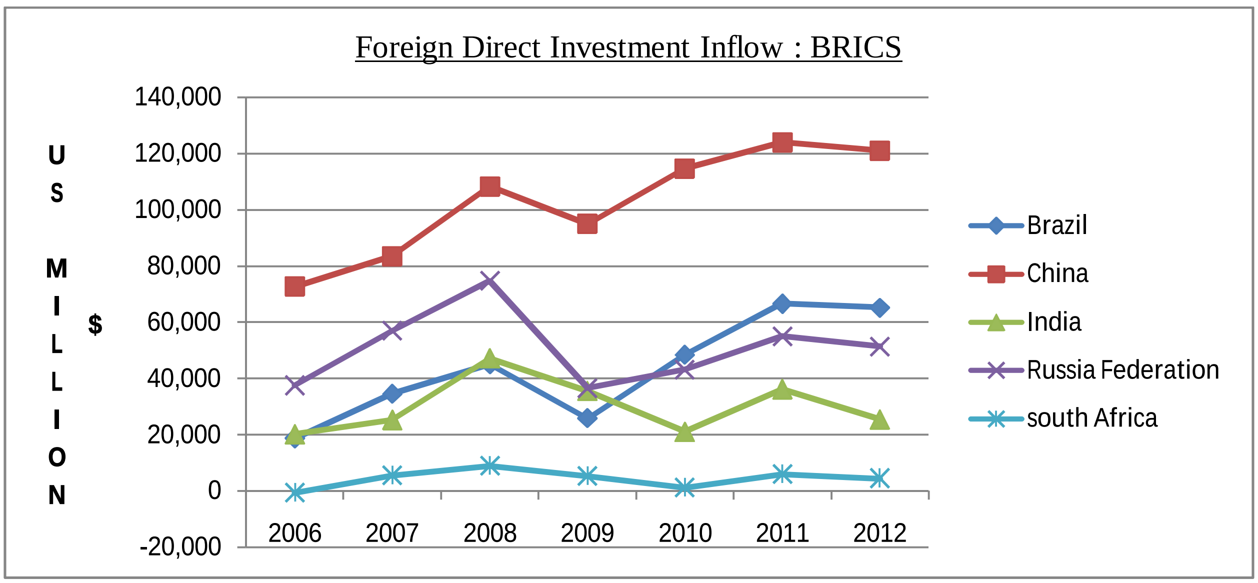
APPENDIX

Fig 1- India- Macro Economic Summary



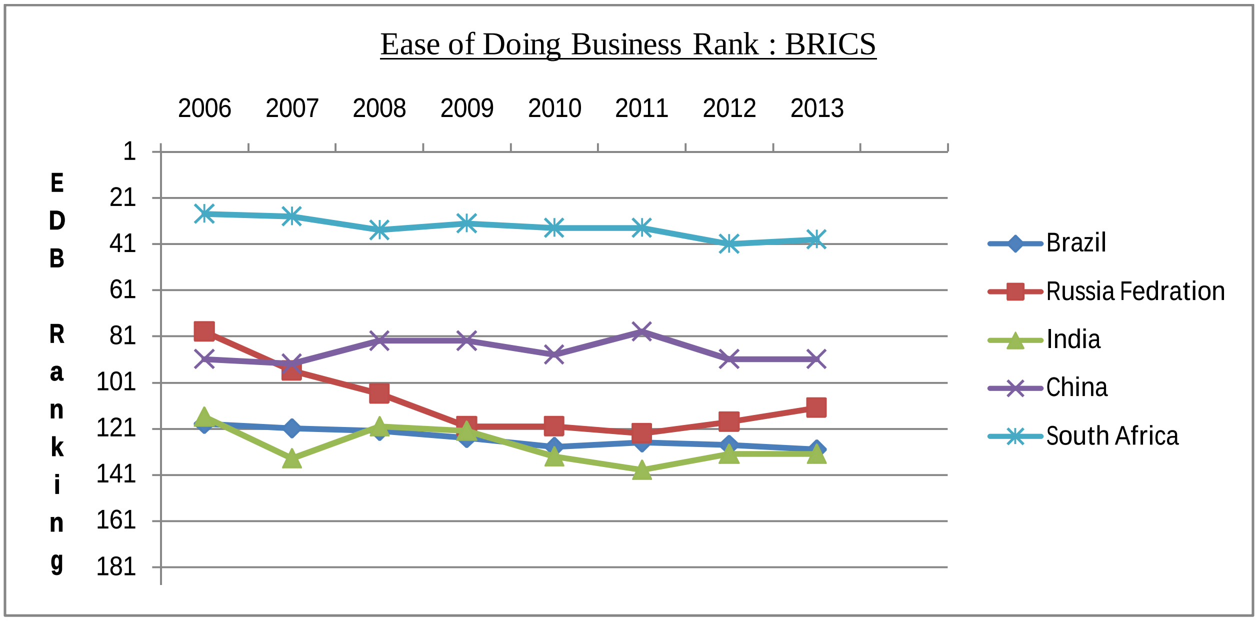
Source : Planning Commission, India- Macro- Economic Summary : 1999-2000 to 2012-13(E) as on 15th March, 2013. Retrieved on 27/9/2013 http://planningcommission.nic.in

Fig. 2 Foreign Direct Investment Inflow: BRICS Economies



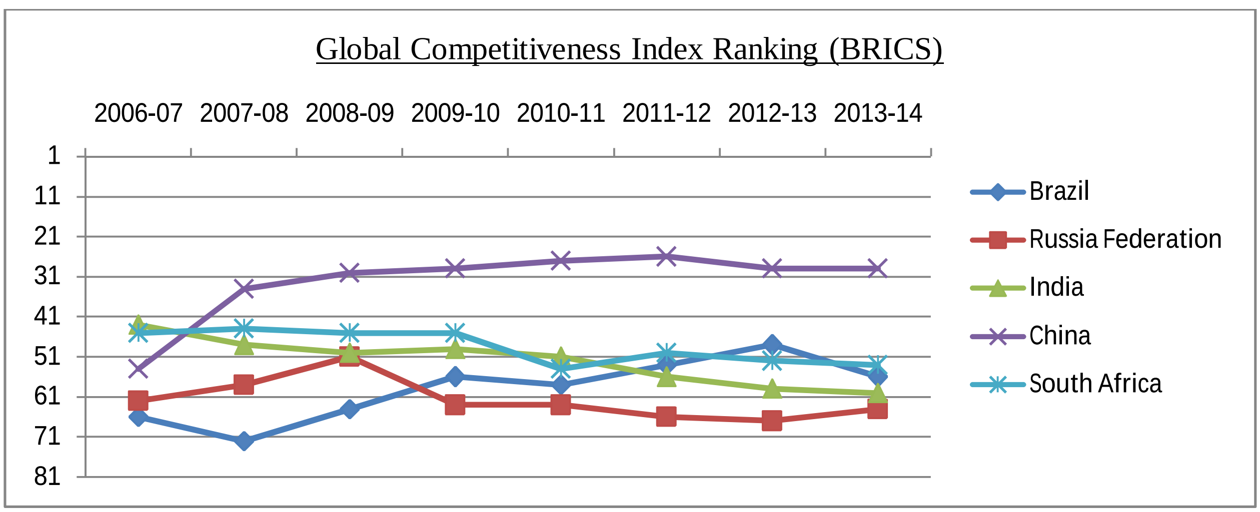
Source: World Bank World Development Indicator.

Fig. 3 Ease of Doing Business Ranking (BRICS)



Source: World Bank Ease of Doing Business Report, Various Issues.

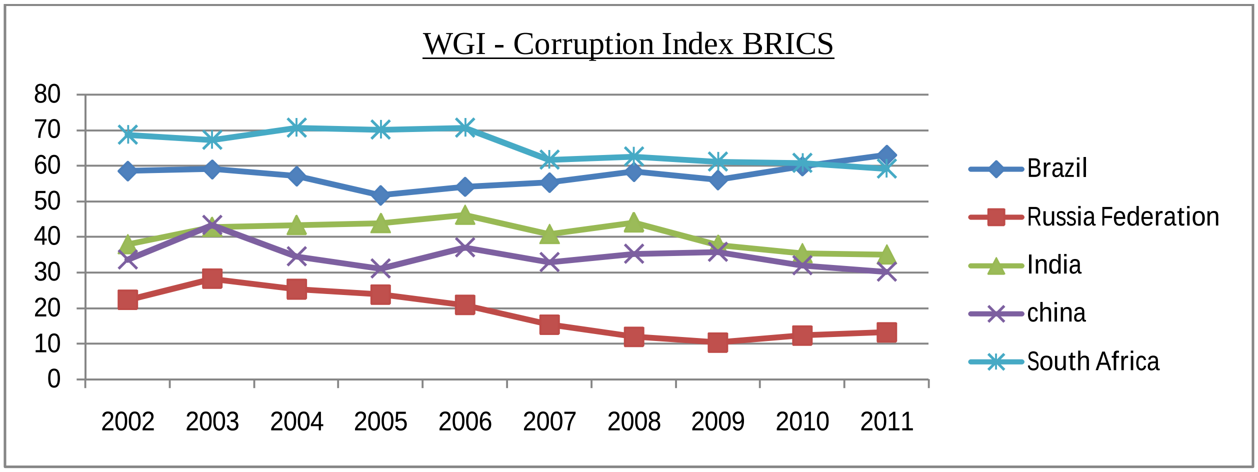
Fig. 4 Global Competiveness Index (BRICS)



Source: GCI, World Economic Forum. Retrieved on 23/9/2013

Ranks: Higher the rank less will be the competitiveness, lesser the rank more will be the competitiveness.

Fig. 5 World Wide Governance Index (BRICS)



Source : World Wide Governance Index by World Bank, Corruption Index (Percentile Rank), Higher the rank less corrupt the country is.

Fig. 6 Quality of Infrastructure (BRICS)

Quality of Infrastructure (Scale: 1 = extremely underdeveloped, to 7 = extensive and efficient by international standards; 2011-12 weighted average)												
Country	Overall		Roads		Railroads		Ports		Air Transport		Electricity	
	Rank	Value	Rank	Value	Rank	Value	Rank	Value	Rank	Value	Rank	Value
BRIC Countries												
Brazil	107	3.4	123	2.7	100	1.8	135	2.6	134	3.0	68	4.9
China	69	4.3	54	4.4	22	4.6	59	4.4	70	4.5	59	5.2
India	87	3.8	86	3.5	27	4.4	80	4.0	68	4.7	110	3.2
Russia	101	3.5	136	2.3	30	4.2	93	3.7	104	3.8	84	4.3

Source: World Economic Forum, Global Competitiveness Report 2012-13.