Outward Foreign Direct Investment from Emerging Economies

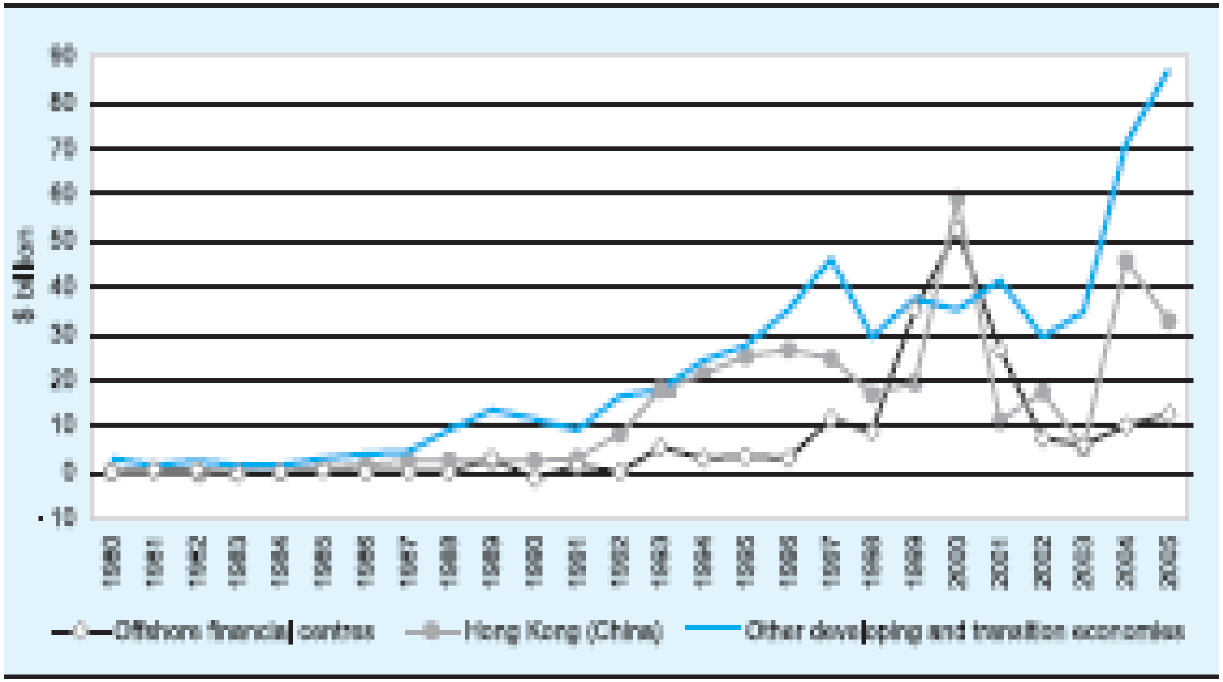
Prof. Dr. R. Veugelers

KULeuven and BEPA-EC

Trends on OFDI from Developing /Transition Economies

- Increasing in absolute and relative terms
- Potential OFDI Performance Index (UNCTAD, WIR) suggests potential for future expansion

Figure 3. Outward FDI flows from developing and transition economies, 1980-2005



Source: UNCTAD, *World Investment Report 2006: FDI from Developing and Transition Economies*, figure III.2.

Trends on OFDI from Developing /Transition Economies

- Still
  - Small number of countries and companies involved (China, Russia..), although gradually spreading
  - By sector: tertiary sector (business, finance, trade-related cf off-shore financial centers)); recently, growth in primary (oil, gas, mining cf Russia); also manufacturing (electronics & cars mostly from SEAsia)
  - Destination: South-South FDI overrepresented; Intra-regional (Intra-Asia: China); (Intra LA: Brazil), (Intra-Africa: SA)

Table 7. Top 15 developing and transition economies in terms of stocks of outward FDI, 2005 (Billions of dollars)

Rank	Economy	2005
1	Hong Kong, China	470
2	British Virgin Islands	123
3	Russian Federation	120
4	Singapore	111
5	Taiwan Province of China	97
6	Brazil	72
7	China	46
8	Malaysia	44
9	South Africa	39
10	Korea, Republic of	36
11	Cayman Islands	34
12	Mexico	28
13	Argentina	23
14	Chile	21
15	Indonesia	14
All developing and transition economies		1 400

Source: UNCTAD, *World Investment Report 2006: FDI from Developing and Transition Economies*, table III.4.

Table III.8. FDI from developing and transition economies, 1985-2004
(Billions of dollars)

Year	Total *FDI from all developing and transition economies*	FDI from developing and transition economies excluding offshore financial centres Total	 To developed countries	 To other developing and transition economies
1985	4.3	3.8	1.9	2.0
1986	5.1	5.0	2.9	2.1
1987	6.7	6.3	4.2	2.1
1988	12.1	11.6	6.8	4.8
1989	19.6	15.2	6.7	8.5
1990	12.7	11.6	5.0	6.5
1991	13.7	10.7	3.7	7.0
1992	24.8	23.0	5.1	18.0
1993	40.8	34.1	2.6	31.5
1994	48.6	39.3	4.1	35.2
1995	55.0	46.3	4.6	41.8
1996	64.8	50.5	5.0	45.5
1997	82.7	54.5	11.0	43.5
1998	54.9	16.3	1.1	15.2
1999	91.9	38.7	7.5	31.2
2000	145.9	73.3	24.7	48.6
2001	78.4	46.5	10.7	35.9
2002	54.4	43.5	12.2	31.2
2003	46.3	36.6	9.6	27.0
2004	128.8	60.8	1.0	59.8

Differences in sectors, home and host countries

makes it difficult to generalize wrt
motives for OFDI from emerging economies
hence
also difficult to generalize wrt
effects on home and host economies

Motives for OFDI from Emerging Economies
(UNCTAD WIR 2006)

- Access to Markets most cited motive, similar to OFDI from developed
- But also Access to Resources & Inputs for feeding fast growth
  - Cf national resources-China
- Strategic motives assigned to state-owned/controlled TNCs in *strategic sectors* by home governments (China, Russia)

Motives for OFDI from transition economies: the legacy of the past

Some evidence from Russia and Slovenia

Russian OFDI

- The majority of Russian outward FDI has been carried out by relatively few **industrial giants** whose significant export revenues have played a key role in supporting and financing the growth of their overseas business expansion and acquisitions
  - Russian transnational corporations in oil, gas and metal industries (Gazprom, Lukoil, Norilsk Nickel, RUsal) are the major players, but telecommunications companies are also actively investing abroad.
  - In estimation, the **oil & gas** sector covers nearly 60% of the value of outward FDI by Russian companies
  - The largest proportion of Russia's outward FDI has gone to the countries of South-East Europe and the CIS.
- OFDI is partly driven by lack of investment opportunities at home. Abroad these companies mostly seek access to resources upstream as well as control of downstream assets: direct access to foreign markets.

Russian TNCs

Table 4 Russian top 10 companies ranked by foreign assets, as of 1.1.2005

Company	Industry	Assets		Sales	
		Total	*Foreign*	*Total*	*Foreign*
Gazprom	Oil and gas	104 982	...	36 422	16 149
Lukoil	Oil and gas	29 761	10 663	33 845	26 428
Norilsk Nickel[6]	Non-ferrous metals	13 632	2 618	7 033	5 968
Russian Aluminium[7]	Non-ferrous metals	11 500	2 165	5 450	4 440
Mobile TeleSystems	Telecommunications	5 581	1 214	3 887	995
VimpelCom[8]	Telecommunications	4 780	852	2 147	45
Severstal	Ferrous metals	5 919	666	6 648	3 954
Yukos[9]	Oil and gas	18 514	607	16 566	12 546
Rosneft	Oil and gas	25 987	319	5 275	3 438
OMZ	Heavy engineering	901	347	524	272
UES of Russia	Electrical energy	40 613	211	24 493	441

Russian OFDI

- **Gazprom** with the State as its largest shareholder has **operations in 17 countries in the European Union**, involving natural gas distribution and processing activities. In addition, Gazprom has operations in nearly all of the CIS countries. In the Baltic States, Finland, and several CIS countries, Gazprom is the sole provider of natural gas. Gazprom holds a 51% share in the joint German-Russian venture, established for the construction of the North European Gas Pipeline (NEGP). It owns 35% of Wingas, a German distribution company.

Slovenia OFDI

- Although still very modest, and much less important than IFDI, OFDI has been increasing (2231 million EURO 2004, 17% increase from 2003)
- Mostly into former Yugoslav republics (73%), rest into EU
- About half in greenfield companies
- Half in manufacturing, but services (esp retail) on the rise

Motives for Slovenian FDI

Damijan, 2007, Slovenian Investment activity in SEE: trade-promoting or efficiency-seeking motivation?

Market related (sales promotion and security of payments) rather than efficiency seeking

- only 20% of firms have established local production facilities

Damijan et al, 2007, Outward FDI and Productivity:micro-evidence from Slovenia, World Economy.

Slovenian OFDI firms are not more productive than exporting firms

– But new OFDI with first-ever foreign affiliates are more productive . Legacy of the past

Impact on home economy:
improvement of TNC competitiveness

- Improvement of TNC competitiveness
  - From exposure to global competition
  - From learning & acquiring “assets” abroad

But, from evidence on effects of OFDI (from developed economies)

- Know-how acquired abroad is not always transferred back to home: depends on
  - motive and location of investment
    - South-South and resource access: reduced scope for asset-augmented OFDI
  - Absorptive capacity and Framework conditions at home
    - Most productive firms are TNCs? Open, competitive markets at home?

Impact on home economy: spillovers to others

- The advantages acquired by TNCs abroad do not always leak outside the TNC's boundaries to other home country firms and institutions.
  - Firm level studies from developed countries show mixed evidence on TNCs generating positive spillovers on the home economy: *competition versus technology spillovers.*
  - Positive technology spillovers require that TNCs are locally embedded in their home market, and that home country firms have the necessary absorptive capacity.
    - Framework conditions and absorption-adept actors at home?

Impact on host economies

- Direct positive effects from econon value created by TNCs in host market
- Indirect effects on local companies: competition effects (negative) and technology spillover effects (positive),

But, evidence on effects of OFDI on host economies (from developed economies) shows mixed results on TNCs generating positive indirect effects on the local economy.

  – Technology spillovers from the TNC to the local economy not always materialize, the host country's firms' technology gap relative to foreign subsidiaries and the host country's indigeneous capacity to absorb foreign technologies.

Impact on host economies: *other South (most frequent)*

- As compared to effects from OFDI from developed countries:
  - OFDI from developing countries could leave higher benefits:
    - Less wide gap, easier to close: from being closer in technology space
      - OFDI from developed countries use easier and more labour-intensive technologies
    - Geographical, cultural and political proximity
  - Political and social aspects

Impact on host economies: *developed countries*

- As compared to effects from OFDI from developed countries:
  - Less scope for positive technology/know-how spillovers
  - Political aspects:
    - Concern about control of “strategic sectors” by state-owned/controlled TNCs
      - Increased risk for transactions being undertaken for other than purely economic motives

EU-25 FDI inflows from extra EU origins

	2003	**2004**	**2005**
Russia	*0.6%*	*0.4%*	*4.4%*
China (incl HK)	1.4%	8.7%	1.6%
India	0.5%	0.0%	0.2%
Brazil	-	7.6%	5.8%
US	42.0%	17.5%	18.2%
Japan	3.2%	14.2%	6.5%
TOTAL (EURObln)	**123.5**	**53.1**	**94.1**

Source: Eurostat (2007), Statistics in Focus 55/2007

Note: extra-EU FDI are driven by cross-border M&A.

Large individual transactions can weigh heavily on the aggregate data leaving the FDI series volatile over time.

Concerns in EU on OFDI from emerging markets, esp in strategic sectors, and from state-controlled or protected TNCs

Call for closing our markets? Differential treatment of OFDI from certain countries in certain sectors (eg Russia in energy); Requesting reciprocal access and openness

Both host and home economies need to be careful with preferential treatment of Outward and Inward FDI and with protectionist measures