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Editor: Lisa Sachs (Lsachs1@law.columbia.edu)
Special Editor for this Issue: Vishwas Govitrikar (Vishwas.Govitrikar@law.columbia.edu)

The growth of Brazil's direct investment abroad and the challenges it faces

by

Luís Afonso Lima and Octavio de Barros*

The internationalization of Brazilian companies is a relatively recent phenomenon. From 2000 to 2003, outward foreign direct investment (OFDI) averaged USD 0.7 billion a year. Over the four-year period 2004–2008, this average jumped to nearly USD 14 billion. In 2008, when global FDI inflows were estimated to have fallen by 15%, OFDI from Brazil almost tripled, increasing from just over USD 7 billion in 2007 to nearly USD 21 billion in 2008 (annex figure 1 below). Central Bank data put the current stock of Brazilian OFDI at USD 104 billion, an increase of 89% over 2003. Caution is in order about these figures, however, as in Brazilian outflows it is difficult to separate authentic FDI from purely financial investment under the guise of FDI. According to the most recent data, 887 Brazilian companies have invested abroad.

Along with other emerging economies, Brazil is suffering from the effects of the global financial crisis. The OECD forecasts that M&A spending from Brazil, Russia, India, China, South Africa, and Indonesia will be reduced by 85% in 2009, in comparison to 2008.[1] This matches the partial performance captured in the data already released: in the period January-May 2009, Brazilian OFDI shrank by 87% in comparison to the same period in 2008, from somewhat under USD 8 billion to somewhat under USD 1 billion. If this trend persists, outward FDI from Brazil will be no higher than USD 4 billion in 2009, as against USD 21 billion in 2008.

Notwithstanding its remarkable recent growth, OFDI from Brazil needs additional support through sound public policies. As we indicate below, this is one lesson that comes home to those who observe Brazilian outward investors closely.

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* Luís Afonso Lima is Chief Economist of the Telefonica Group and President of SOBEET – Sociedade Brasileira de Estudos de Empresas Transnacionais e da Globalização Econômica – and may be contacted at luis.lima@telefonica.com.br. Octavio de Barros is Chief Economist at Banco Bradesco and may be contacted at 4968.octavio@bradesco.com.br. The authors are grateful to Afonso Fleury, Marcílio Moreira, Michael Mortimore, and Marcia Tavares for their suggestions. **The views expressed in this article do not necessarily reflect the opinions of Columbia University or its partners and supporters.** *Columbia FDI Perspectives* is a peer-reviewed series.

[1] *OECD Investment News*, June 2009, Issue 10.

Characteristics of outward FDI from Brazil

Despite its relative novelty, the internationalization of Brazilian companies has achieved a wide geographic spread. Brazilian OFDI can today be found in 78 countries. Admittedly, some destinations matter more than others. Putting aside investment in tax havens, which accounts for 67% of the total, by 2007, half the stock of OFDI from Brazil had gone to Denmark, the United States and Spain, with developed economies together accounting for 75% (annex figure 2). Among emerging markets, Argentina leads, followed by Uruguay. When it comes to sectoral distribution (and including tax havens), Central Bank data indicate that 54% of OFDI stock from Brazil had gone into financial services by 2007 (annex table 1). Given the distortion introduced by the inclusion of flows to tax havens, however, it is difficult to arrive at a realistic picture of the final destination of these flows, be it geographical or otherwise.

The internationalization of Brazilian companies is dominated by the private sector, although state-owned enterprises also play a role. Petrobras, for example, has expanded its overseas activities to 15 countries in three continents. In Latin America, the company has energetically pursued a strategy of regional integration in natural gas.

Why are more and more Brazilian companies going abroad? The most frequently cited reason is that they are following clients into international markets. But there are many other reasons as well, such as defending their competitive position, monitoring the competition in international markets, meeting international demand and reducing their dependence on a single (domestic) market. Many Brazilian companies are also interested in natural resources. Yet others are looking for lower costs, better infrastructure and more attractive fiscal incentives. Broadly speaking, Brazilian outward investors are in search of three things: markets, natural resources and investment climates superior to the one they find at home.

In keeping with the usual pattern of early internationalization, one of the main ways in which OFDI from Brazil begins is by setting up offices for overseas sales. This is especially common in the consumer goods industry and the services sector. However, the overseas manufacture of goods and provision of services account for a substantial share of OFDI as well. According to a SOBEET survey[2] of 211 companies, which had a 30% response rate, the OFDI of 38% of the companies consisted of sales offices and only 23% had productive units abroad. However, the latter accounted for a much larger portion of outward investment than the former. Brazilian overseas units also tend to expand into new functions, such as manufacturing goods and providing services, even if not initially set up to do so. It is interesting too to note how other, more sophisticated, functions such as logistics and R&D, already figure among their overseas activities.

Despite the speed and scale of the Brazilian internationalization process since 2004, there are some surprises when it comes to the sources of funding. Most Brazilian companies investing abroad indicate their own capital as the main source of funding. However, many of those that do *not* mention their own capital also do not mention other Brazilian sources. This suggests that access to funds from BNDES (the Brazilian Development Bank) or from domestic banks is still limited. If this were remedied, the process of internationalization might well become more dynamic. But the lack of Brazilian financing is not the only internal barrier to the internationalization of Brazilian companies. Many Brazilian companies also mention the lack of personnel with the necessary skills and the knowledge of potential markets.

Among external obstacles, the tax burden is pre-eminent. According to SOBEET's 2008 survey of Brazilian multinationals, taxation – and especially the prospect of double taxation – is a major problem

[2] *Carta Sobeet nº. 46*, "Brazilian transnational companies: survey results", November 2008.

for internationalization. Brazil has signed only 12 double taxation treaties in the past 10 years. As a matter of fact, the lack of double taxation treaties is a major concern for Brazilian multinationals.

Conclusion: The need for public policies to remove obstacles for Brazilian OFDI

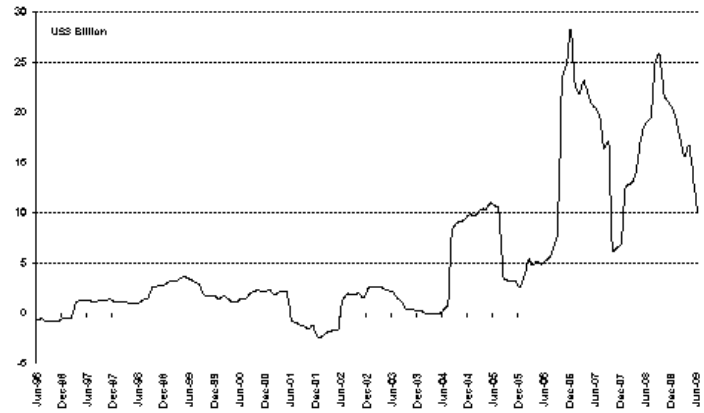
The internationalization of Brazilian companies, like the internationalization of their counterparts in other emerging markets, is not a flash in the pan. And this internationalization is just beginning. Among the known benefits of OFDI is the fact that it stimulates exports.[3] Another is the improved competitiveness of Brazilian enterprises. Given this, it is important that the Government of Brazil rethink its policies and, in particular, undertake an overhaul of those policies that inhibit Brazilian OFDI.

One group of policies that need rethinking is policies on international taxation. Another group concerns bilateral treaties to protect and promote investment. Perhaps the most important kind of policy that needs reform, however, relates to financing. Despite the fact that BNDES does have specific credit lines for OFDI, a greater availability of funds would be helpful to companies considering cross-border investment, especially at a time when the credit crunch that followed the financial crisis has become near universal.

[3] See Glauco Arbix, Mário Sérgio Salemo and João Alberto De Negri, *Inovação, via internacionalização, faz bem para as exportações brasileiras* (Brasília: Ipea, 2004). (Texto para Discussão, n. 1.023).

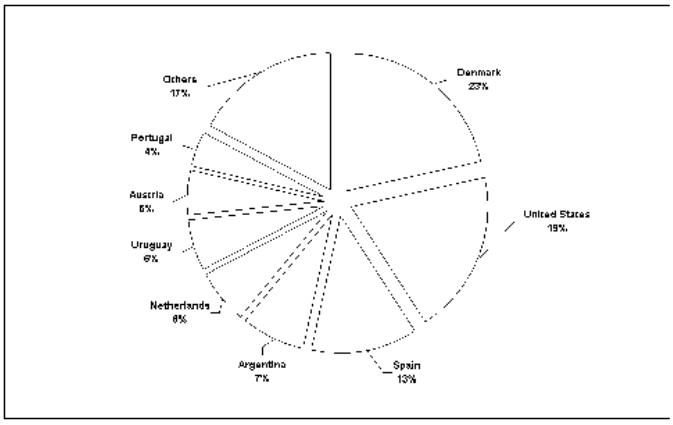
ANNEX

Annex figure 1: Outward foreign direct investment, June 1996–June 2009



Source: Central Bank of Brazil.

Annex figure 2: Destinations of Brazilian OFDI stock as of 2007, excluding tax havens.



Source: Central Bank of Brazil.

Annex table 1: Sectoral distribution of Brazilian OFDI stock as of 2007, as percentage of total (including tax havens)

Activities related to financial services	53.8
Administrative support	10.5
Other technical activities	8.8
Consulting	5.9
Auxiliary financial services	3.5
Whosale activities	3.4
Oil and natural gas	1.9
Others	12.3

Source: Central Bank of Brazil.

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For further information please contact: Vale Columbia Center on Sustainable International Investment, Karl P. Sauvant, Executive Director, (212) 854-0689, Karl.Sauvant@law.columbia.edu or Lisa Sachs, Assistant Director, (212) 854-0691, Lsachs1@law.columbia.edu.

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