Foreign direct investment on brazilian economy

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Over the last few decades, foreign direct investments (FDI) have played a very relevant role in Brazilian industrialization, attracted especially by the large domestic market. The political stability and government policies are also key factors attracting foreign investors. Because FDI can bring major benefits to recipient economies by enhancing their competitiveness, the competition to attract FDI has intensified among countries, especially developing countries like Brazil.

Theoretically, foreign direct investment depends on the monopolistic advantage of MNCs or comparative advantages in host economies (Hymer, 1976; Kojima, 1978; Dunning, 1980, 2000)1. According to Porters (1990), competitive advantages of local industries depend on four factors: factor conditions, demand conditions, context for firm strategy and rivalry, and presence of competitive related and supporting industries. In addition, external factors and government also play an important role in influencing industrial competitive advantage. Dunning (1993a, p. 8) argues that Porters does not sufficiently take the globalization of economic activity into account and MNC influence is added to Porter's diamond. Inward FDI can bring new resources and technologies into a country and foreign investors can import advantages from its home base and some of its assets might contain ownership specific advantages (Dunning 1993, p. 108). For Dunning, each factor of the diamond is linked to multinational activity.

The impact of the activities of MNCs on National Competitiveness

It was suggested that MNCs may stimulate development in host economies, as foreign subsidiaries could introduce new know-how, stimulate

competition, and transfer production techniques and management skills and these ownership advantages are believed not only to affect the nation’s productivity directly, but also indirectly through spillovers to improve overall efficiency in the economy and trade performance (Blomstrom and Kokko 1998, p. 256; Narula and Marin 2003, p. 1)2.

The macro-economic difficulties experienced by Brazil as of the early 80s caused a drastic reduction in infrastructure investments, which until the mid-90s were almost exclusively the responsibility of the public sector. The FDI reduced the deficiency in the infrastructure. Many acquisitions took place in the privatization of public companies (industrial and public services such as electricity and telecommunications). Unlike the FDI destined to building new assets, acquisition earmarked for buying pre-existing assets. In this case, the relation between FDI and increase in productivity of economy is indirect. It depends on whether additional investments are made on modernization and expansion of product capacity of the acquired asset.

FDI Impacts on productivity level of Brazil economy

Foreign firms with greater technological capacity may directly boost the average productivity level of the host economy by importing capital, advanced assets and proprietary technology and could cause technology spillover indirectly. FDI is generally regarded as a source of modern technology including product, process and distribution expertise, as well as management and marketing skills (Blostrom and Kokko 1998, p. 247).

According to the literature, these spillovers would occur due to two effects- competition effect and demonstration effect. In terms of competition effect,

increased rivalry of foreign competitors force national companies to innovate and modernize their production and management technologies. As price competition becomes more intense, domestic and foreign firms have an incentive to differentiate their products and enhanced rivalry of MNCs ensures that only the most appropriate management practices survive. Regarding to demonstration effect, national companies could learn superior production technologies taking advantage of the arm's length relations with MNCs (Gorg and Strobl 2001, p. 723)3. Here, the absorptive capacity of domestic firms plays a crucial role. It was argued that the impact is greater when domestic firms and MNCs have similar levels of productivity (Driffield and Taylor 2002)4.

Export coefficient: Exports in relation to turnover; Import coefficient: Imports in relation to turnover

Table 1 shows that foreign firms in Brazil are indeed larger and more productive than national firms. In the same way, their workers appear to have more qualification and advertising expenditure also occupy a greater proportion in the turnover. (It is assumed that the more intensive use of technology demands greater qualifications in the staff operating it. In the same way, the greater the sales effort involved, represented by its advertising costs, the greater on averages the differentiation of the firm's product.)

5Goncalves (2003), based on a sample of 22, 000 companies with data from 1997 to 2000, sought to check the existence of productivity spillovers from foreign to national companies using a panel econometric model at firm level. However, contrary to expectations, there was no evidence of spillovers,

either positive or negative. Then the national companies were classified according to their productivity gap with foreign companies in the same sector to test if companies with different levels of productivity would have different capacity absorbing potential spillovers. It was again surprisingly to find that the national companies with a narrower productivity gap were negatively affected and for those with a wider gap, the effect was positive. Therefore, according to Goncalves' results, for the largest national companies competing directly against foreign companies in national market, the increased foreign share did not have a dramatic effect on productivity for the industrial structure as a whole, since the negative effects surpass the positive spillovers.

This might due to decline in scale and the MNCs' shift to lower value-productivity activities. In the 90s, faced with greater competition from imported products, the MNCs tried to achieve higher degrees of productive specialization and lower levels of vertical integration which led to increasing imported component in the final products manufactured in Brazil by reducing the local value added on final goods production.

Opening the domestic market to foreign competitors will not only increase competition between the direct rivals of the MNCs, but also enhance competition at the level of local suppliers which will lead to the development of related and supporting industries. Because of the competition effect, Brazilian MNCs enabled local suppliers to develop specific skills to meet the new requirements for lower prices and higher quality product to differentiate from competitors. These are known as forward and backward linkage, as subsidiaries train and instruct their local suppliers, subcontractors and

customers. The subsidiaries of MNCs shift from the stand-alone model of operation towards a model of integration with the network between corporations involved in the production and trade.

The upgrading of human capital is consequence of and a complement to technology transfer (Narula and Marin 2003, p. 6)6. Under the competition effect, national companies require for higher quality products with superior technology. Therefore, the demand for skilled labours increases as the development and effective use of technology requires human capital (Driffield and Taylor 2002; Lall 2001, pp. 128-131). Upgrading of human capital can occur through training or the movement of highly skilled staff from MNCs to domestic firms. MNCs

FDI impacts on Brazilian trade performance

In literature, foreign corporations have a greater international orientation than national companies, although this difference is higher for imports than for exports. Table 1 again shows that foreign companies are indeed better off in many aspects with greater competitive advantages and export potential than the national firms. However, the small difference between the export coefficients and the significant import coefficients difference seem to indicate that these competitive advantages were not translated into a more effective trade performance.

It also shows that foreign companies' contribution to positive trade balances was small because of the higher level of imports. One of the major advantages of MNCs over domestic companies is its well-established trade

network and it was shown that these advantages were used mainly to increase import flows.

MNCs distribution in Brazil – 2000

Source: Central Bank of Brazil

Trade liberalization and exchange-rate appreciation during most of the 1990s increased imports dramatically, especially for the MNCs with international trade network to import technology-intensive inputs, while with no corresponding increase in exports. Foreign companies had an average propensity to export (exports/sales) of 14. 3% in average and an average propensity to import of 13. 6% in 2000. According to the Pie Chart 1, nearly half of total investment have both export and import propensity below than the average. This is because that these investments largely comprise service industries, which were oriented toward the domestic market and therefore had little influence on trade flows. The chemicals, telecommunications sectors with import propensity above average and export propensity below average, which accounted for 31% of the accumulated flows between 1996 and 2005. These industries prioritized the domestic market, but with a high volume of imported inputs and components. The resource-seeking industries such as mining have higher export propensity and lower import propensity which accounted for 10. 4% of the total investment. The industries such as automobiles and machinery have both high export and import propensity. This is notified that the difference in the industrial size and distribution from other developing countries which are also attractive for FDI, such as Korea. Take the example of Korea, by the 1970s, its government was pushing Korean large business groups into a variety of new sectors with cheap credit

and few limits on borrowing. Moreover, the export push meant that their business groups were not held back by the limitations of the Korean market. In Brazil, however, import-substitution industrialization greatly limited markets, though Brazil itself has large domestic market, it is insufficient especially after the crisis in 80s. In addition, large firms from Asia are more concentrated in middle- and high-technology manufacturing, such as automobiles, computers. Brazil, however, has relatively small proportion of the large firms in this sector.

7Hiratuka and De Negri (2005) suggest that most of Brazil's imports of equipment required for local production are from their parent MNCs home countries and their major export destinations are the Brazilian domestic market and neighbor countries. Foreign subsidiaries tend to import from their home countries technology-intensive products, inputs, and components which results in significant differences between exports and imports flows not only in value, but also in terms of technological profile. According to literature, the increased foreign shares should have positive spillover effect on exports because MNCs cost to enter the international market is lower. However, as there is small difference in Brazilian export coefficient, there is no evidence to show the existence of this spillover.

To sum up, the liberal trade policy and exchange rate appreciation increase the imports of MNCs subsidiaries, especially the highly technology-intensive inputs. MNCs, however, have limited impacts on trade flows, because most of the foreign investment in Brazil targets the domestic market.

Conclusion

In terms of productivity, Brazil has no doubt improved the productivity compared with the beginning of 90s. However, its productive structure is currently dependent on the acquisition of imported inputs from MNCs home country in order to produce. The increased imported component, on the other hand, increase the specialization of the local production, thus reduce some of competitive deficiencies of Brazilian industry.

In terms of trade performance, there is an intense increase in the use of imported products in the domestic market. The increased imported content of local production improves the quality and efficiency of production significantly, but did not give rise to a considerable increase in exports.

To sum up, the FDI impact on Brazil is different from other developing countries such as those Asian countries. Take again Korean example, the export share of production has been significantly boosted and the increase of productivity led to the investment abroad of national companies since the 80s. The internationalization in other developing countries expands foreign markets for domestic production through the investments abroad of national companies or the export of domestic production by local and foreign firms. However, in Brazil's case, internationalization had the domestic market as its target through the greater presence of foreign companies and the increase in the imported content of final production.

Therefore, the internationalization process resulted in a productive structure that is a micro economically more efficient, generating more unsatisfactory macro-economic result.