This project has received funding from the European Union's Seventh Framework Programme
for research, technological development and demonstration under grant agreement no 266800

FESSUD

FINANCIALISATION, ECONOMY, SOCIETY AND SUSTAINABLE DEVELOPMENT

Working Paper Series

No 129

Developing and Emerging Countries as Finance Providers: Foreign Exchange Reserves and Direct Investment to the European Union

Bruno Bonizzi and Jan Toporowski

ISSN 2052-8035

Developing and emerging countries as finance providers: foreign exchange reserves and foreign direct investment to the European Union

Bruno Bonizzi and Jan Toporowski

Affiliations of authors: SOAS, University of London

Abstract: This paper evaluates the role of emerging and developing economies as providers of finance to the European Union. In particular it explores the evolution of foreign exchange reserves accumulated in Euro, and direct investment to the European Union from emerging and developing countries. It is argued that such financial flows are unlikely to promote substantial economic development in European countries.

Key words: Foreign direct investment, foreign exchange reserves, European Union, Developing Countries

Date of publication as FESSUD Working Paper: January 2016

Journal of Economic Literature classification F31, F23,

Contact details: b_bonizzi@soas.ac.uk

Acknowledgments:

The research leading to these results has received funding from the European Union Seventh Framework Programme (FP7/2007-2013) under grant agreement n° 266800.

Website: www.fessud.eu

This project has received funding from the European Union's Seventh Framework Programme for research, technological development and demonstration under grant agreement no 266800

Introduction: emerging and developing countries holdings of EU assets

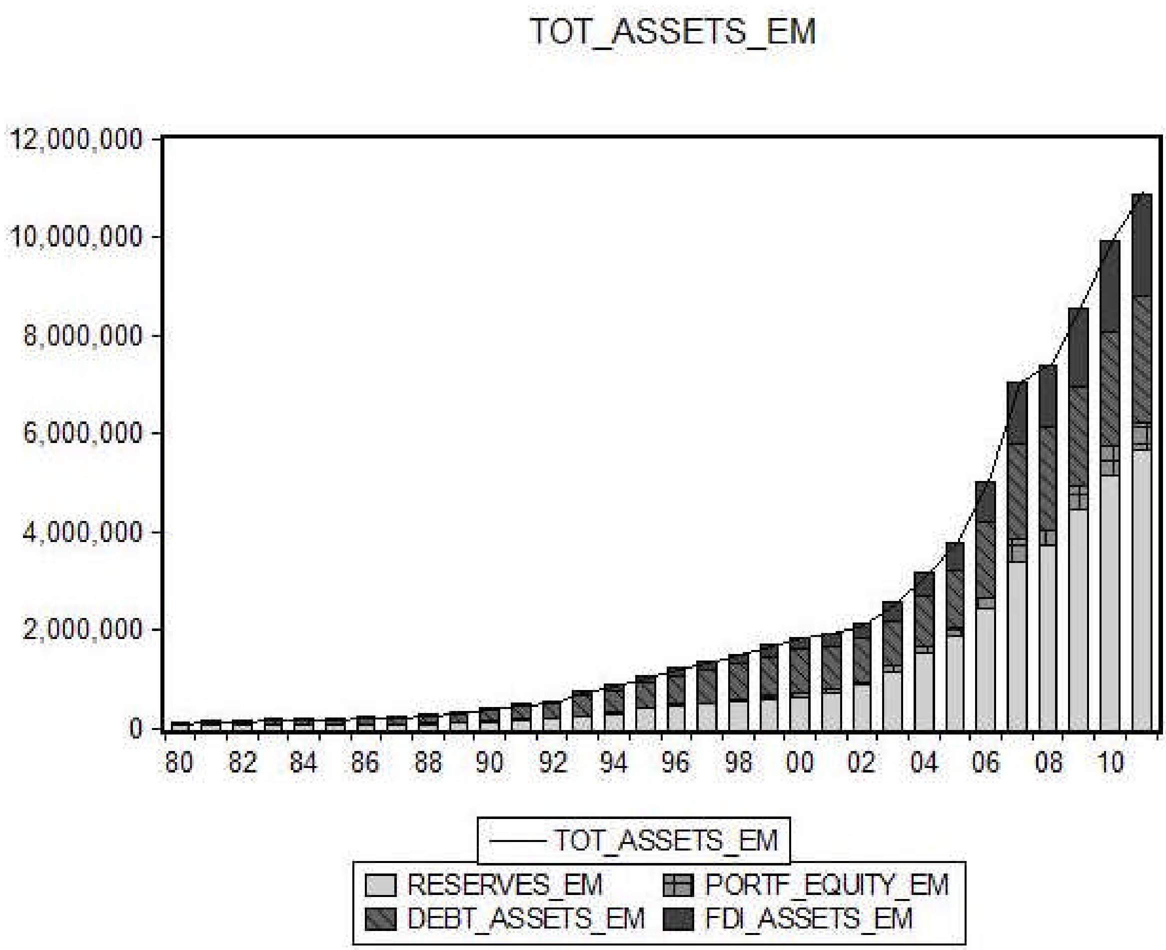
In order to understand capital inflows from the developing countries into the European Union (EU) it is necessary to understand the debt structures that link the developing countries with the EU. These debt structures are not only the debt obligations, denominated in Euros, or to EU official, multilateral or private sector creditors (see Deliverable 6.04) of governments and the private sector in developing countries. They are also assets and companies in the EU owned by residents of the developing countries, emerging markets, and off-shore financial centres frequently located in less developed countries. For convenience therefore, capital inflows into the EU may be classified as holdings of European currency reserves by governments of developing countries and emerging markets; portfolio investment in EU capital markets, including holdings of European assets by Sovereign Wealth Funds in developing countries and emerging markets that are the subject of the companion report of the Deliverable 6.05; and foreign direct investment (FDI) in the EU from developing and emerging markets.

These debt and claim structures are complex and clearly go beyond holdings of EU bank deposits and financial assets as a 'hedge' against debts and owed to EU creditors. They also reflect the limited capital investment absorption capacity of many commodity-exporting countries in the Middle East where Sovereign Wealth Funds are based. This last is also a factor in the rise of multinational corporations based in emerging markets but active in the EU. The steel company Arcelor Mittal is the largest steel producer in the EU, and is financed in the EU, but started as FDI from India, with the purchase of European steel companies by Lakshmi Mittal. However, what is surprising is the extent to which companies from large emerging markets with substantial development potential, most notably the so-called BRIC countries (Brazil, Russia, India and China), are investing in Europe. This is shown in the final part of this report.

Emerging and developing countries' integration into the global financial system has grown substantially over the past few years. As discussed in FESSUD paper 6.04, these countries as a whole recorded high private capital inflows and trade surpluses. The mirror image of this phenomenon was the substantial accumulation of foreign exchange reserves by these countries. This highlights the subordinate role that these countries play into the global financial system: they are mostly recipients of foreign direct and portfolio investments, and accumulate reserves to prevent and contain the volatility that these investments might induce.

As chart 1 confirms, reserves remain crucial in the international investment position of Emerging countries, constituting about half of total external assets. The chart does on the other hand show in more recent years other components have seen an expansion. Emerging and developing countries have started to invest abroad, and diversify part of their reserves into a more mixed portfolio through the establishment of Sovereign Wealth Funds. Moreover, as the chart shows, outward direct investments have substantially increased since 2004.

Chart 1. Total external assets of Emerging Economies - USD millions



Source: Authors' calculation based on (Lane and Milesi-Ferretti, 2007)

This project has received funding from the European Union's Seventh Framework Programme
for research, technological development and demonstration under grant agreement no 266800

Sovereign wealth funds investments into debt markets has been analysed thoroughly in paper 6.05, showing their potential role in purchasing southern European countries government bonds. This paper is therefore going to focus more closely on the other two channels through which emerging and developing countries may provide finance to Europe: foreign exchange reserves and foreign direct investments.

The importance of the Euro as component of foreign exchange reserves has been an intensely studied subject. Before 2008, the importance of the Euro was rising, and a consensus emerged arguing that the Euro could eventually challenge the supremacy of the US dollar as a global reserve currency (Chinn and Frankel, 2005; Papaioannou and Portes, 2008). The continuous depreciation of the US dollar and the expansion of the Eurozone and the EU as a financially and economically stable institution, in a context of increasing trade and financial integration were perceived to be drivers of an increase in the usage of the Euro as a reserve currency.

Foreign direct investment (FDI) to Europe by emerging and developing countries on the other hand has not attracted the same level of attention. Several papers focus on the increasing outward orientation of BRIC - Brazil, Russia, India and China – countries, and study the determinant of their investments (Sauvant, 2005; Gammeltoft, 2008; Holtbrügge and Kreppel, 2012). However, few focus specifically on the analysis of the FDI from these countries to the EU. Clegg and Voss (2012) is an exception, but focus exclusively on China.

This paper contributes to the existing literature in two ways. Firstly it reassesses the role of foreign exchange reserves accumulation as supply of finance to the European financial markets. Secondly, it will present an overview and analysis of FDI from emerging and developing countries and their potential contribution to economic development of Europe.

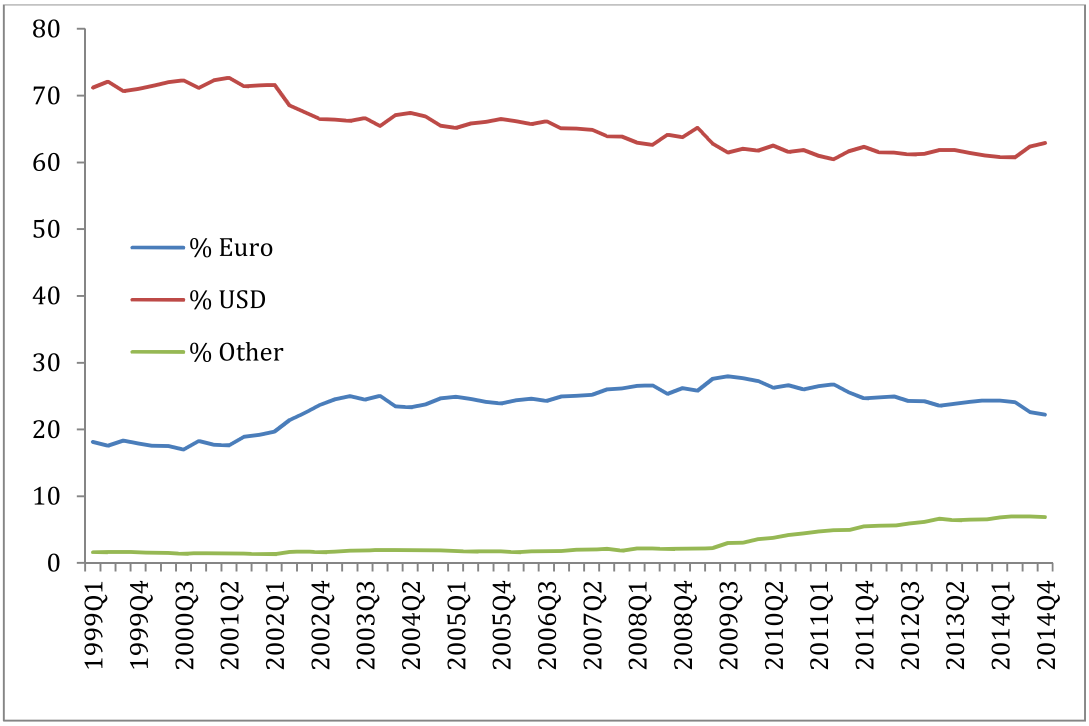
This project has received funding from the European Union's Seventh Framework Programme for research, technological development and demonstration under grant agreement no 266800

1 The Euro within foreign exchange reserves

The Euro has been, since its birth, the second most important currency after the US dollar. A quarter of global debt securities for example are denominated in Euro (ECB, 2014).

The status of the Euro as a major currency is also suggested by its inclusion in the portfolio of Central Banks foreign exchange reserves. Despite the relative small size of euro-denominated trade invoicing (ECB, 2014), the Euro has been the second biggest component of global currency reserves (chart 2): since 2002, between 20-22% of reserves[1] have been held in euro-denominated assets, while US dollar-denominated reserves decreased from 72% to 62%.

Chart 2. Share of World Foreign Exchange Reserves



Source: IMF COFER

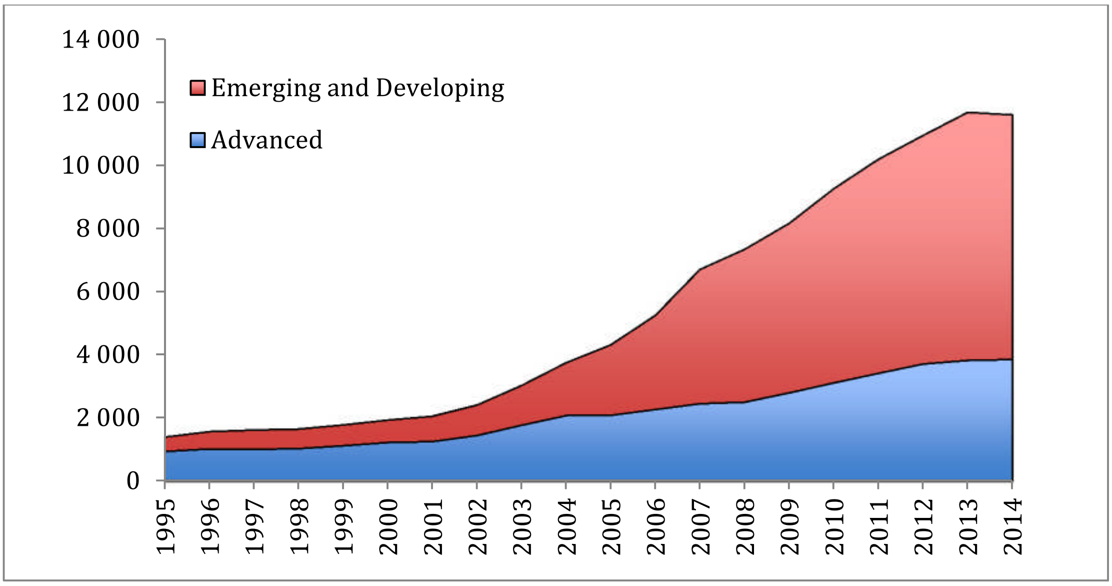
[1] Due to their political sensitiveness, countries do not fully disclose the currency composition of their reserves. In the IMF composition of official foreign exchange reserves database (COFER), about half of the reserves – the figure as of 2014 two thirds of emerging and developing countries and about 12% of advanced economies - are "unallocated", i.e. with unknown currency composition. The considerations made in this section therefore refer to the "allocated" part of reserves.

The presence of official investors provides European debt markets with a wider investor base, which could contribute to lower bond yields. Indeed having lower yields on foreign liabilities and high returns on its assets is what constitutes the "exorbitant privilege" of the US (Gourinchas and Rey, 2005). While the Euro does not seem to have enjoyed the same excess return on its foreign assets (Habib, 2010), its creation has made the costs of borrowing for many governments much lower, effectively equalising their interest rates (Economist, 2011). This may be partly due to the Euro status as a reserve currency.

Developing and emerging countries could have a major role in this process. As shown in chart 3, foreign exchange reserves accumulation has proceeded at a very fast pace since 2000, and this has been mostly driven by Emerging and developing countries. As of 2014, they hold about two thirds of total – allocated and unallocated – currency reserves. Emerging and developing countries therefore, may contribute substantially, if indirectly, to provide stable financing conditions that favour economic development in Europe.

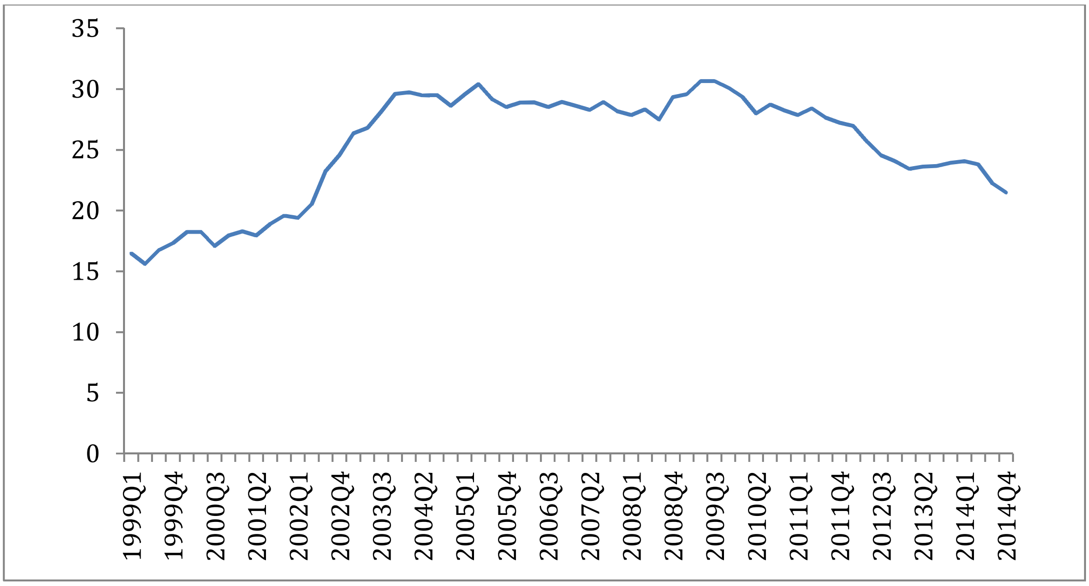
This process however seems to be heavily dependent the financial stability outlook of Europe. The percentage of reserves held by Emerging and Developing countries in Euro-denominated assets has noticeably dropped since the first quarter of 2009, from over 29% to about 21% (chart 4). This seems to be the result of two patterns. Firstly, it follows the increasing diversification of reserves, as testified by the increasing share of "other" currencies in chart 3. Secondly, on top of this there has been an active choice to decrease the allocation to Euro-denominated asset. As a matter of fact, chart 5 shows that the share of the US dollar has remained more or less constant in the same period, while that of the British Pound Sterling has also been decreasing but only by about 1% from 5.9% to about 5%. In absolute terms, Euro reserves have remained constant from the first quarter of 2009 while Pounds Sterling reserves increased by 25 USD billions.

Chart 3. Total Reserves – USD billions



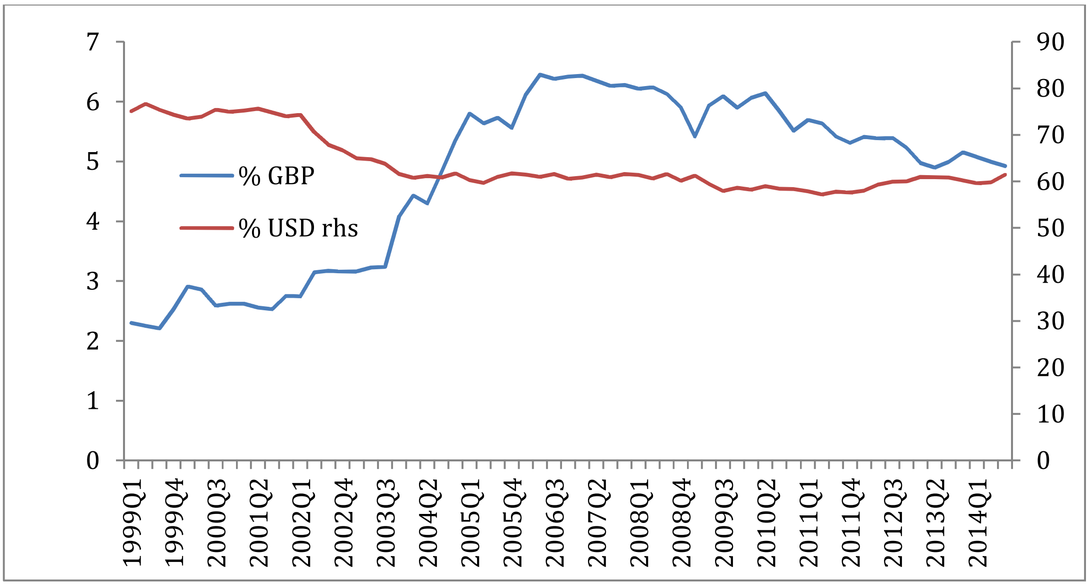
Source: IMF COFER

Chart 4. Emerging and Developing Countries Reserves - % EUR



Source: IMF Cofer

Chart 5. Emerging and Developing Countries Reserves – Other Currencies



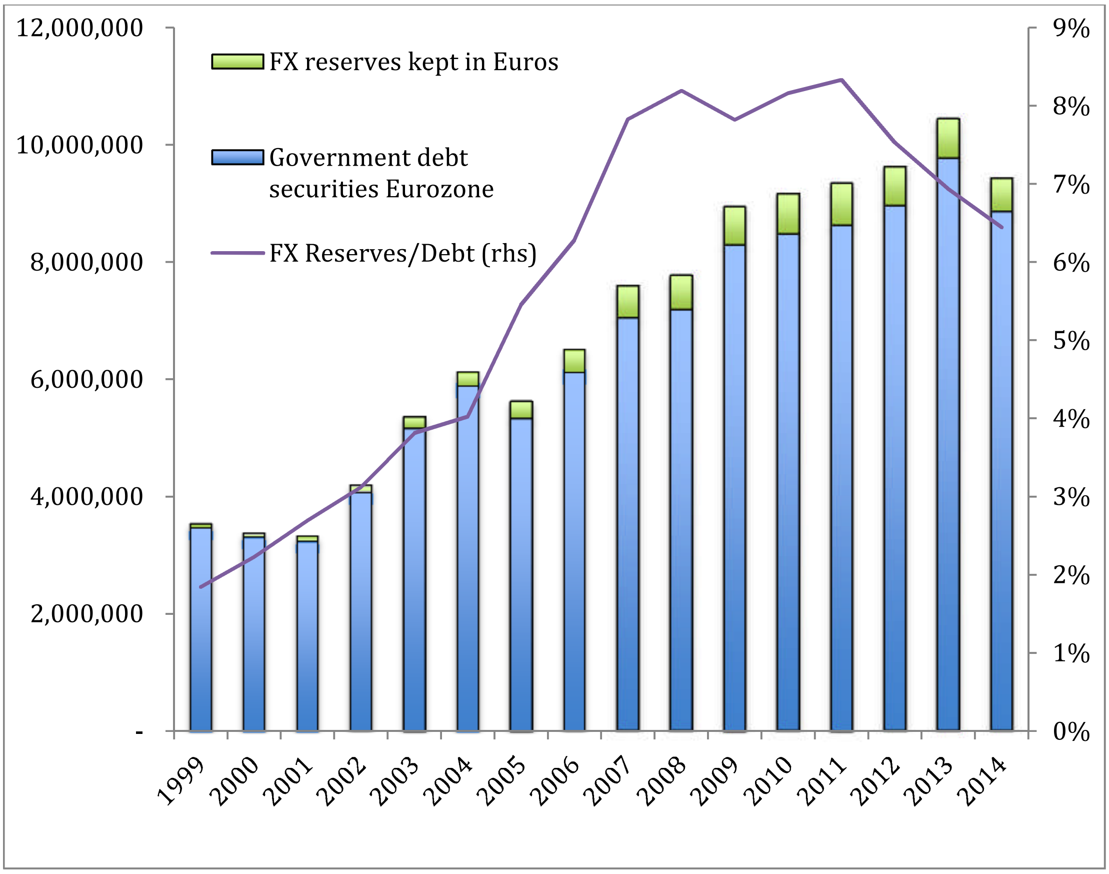
Source: IMF COFER

This change implies that emerging and developing countries seems to take into account the stability of capital markets in the countries to which they allocate their reserves. In Europe, despite over two decades of work in creating an effective common capital market, the stigmatisation of sovereign debt and the fears of a breakdown of the common currency have rendered unattractive markets in Euro-denominated assets. Caution in holding European assets is rational from the point of view of holders of foreign currency reserves since such reserves, when not diversified into sovereign wealth funds, need to be easily disposable to allow for foreign exchange interventions. As a result they are held into liquid and stable securities. Indeed it is likely that within the Eurozone they are held into German and French government bonds (Pineau and Dorrucci, 2006). The increased riskiness or volatility of these assets result in a decreasing allocation by emerging and developing countries central bank

Given these trends, it would seem that foreign exchange reserves have provided less financing to Europe precisely when it was most needed, i.e. the sovereign debt turmoil. This seems to be largely confirmed by chart 6. Foreign exchange reserves of Emerging and Developing Countries increased from 2% to about 8.5% of total Eurozone outstanding government debt in the 1999-2010 period. Since then they have decreased to just above 6%.

This coincides precisely with the timing of the sovereign debt crisis, and in this sense reserve holders behaved exactly like most investors, shifting out of Euro denominated government bonds when their perceived riskiness increased.

Chart 6. Reserves and Government Debt – USD millions



Source: Author's Calculation based on IMF COFER, IMF Exchange Rate report and ECB Statistical Data Warehouse

It would therefore seem that the Euro, while being a major currency remains below the US dollar in the world hierarchy. While the long-run trend sees developing countries diversifying away from heavily dollar-based reserves portfolios, the Euro remains affected by macro-financial "short-term" issues. The US remain remains the ultimate global safe asset issuer – indeed the dollar strengthens during crises (Obstfeld, 2010).

In sum, although most of emerging and developing countries external assets are held as currency reserves, and a substantial part of them is in Euro, this is unlikely to be a major stabilising force to the European government debt markets and therefore foster economic development enhancing through financial stability.

2 Direct Investment to Europe

This section provides an overview of foreign direct investment to EU-member countries. It will look at total FDI, and then dissect by macro-regional aggregates, specific developing regions and sector of destinations.

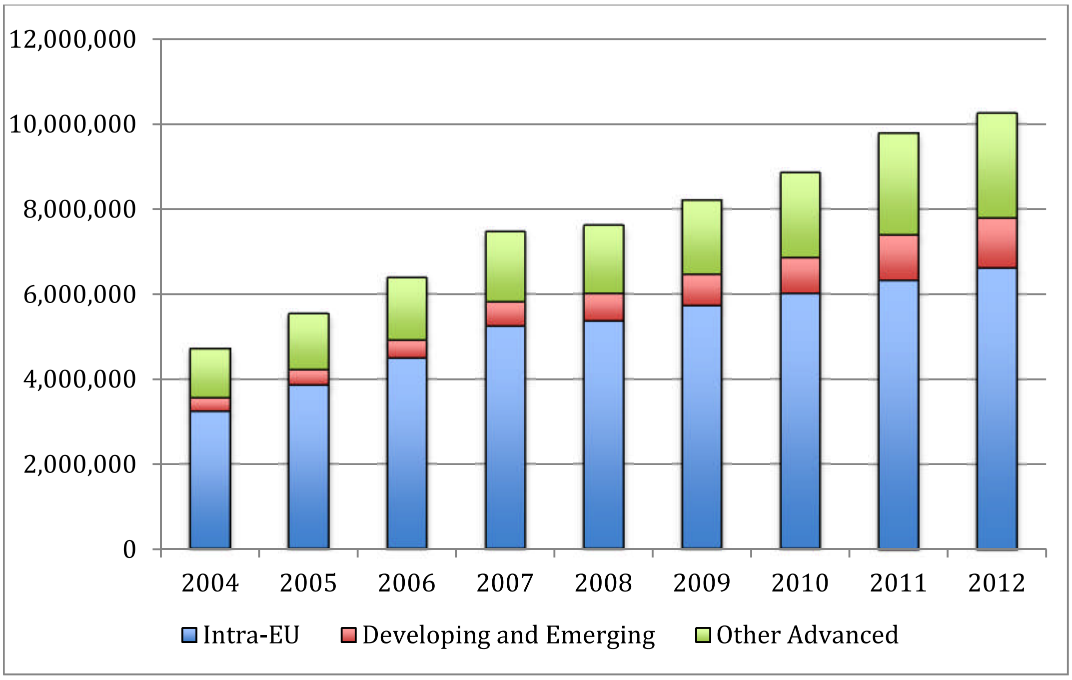
2.1 FDI to Europe: developing and developed investors

Europe is a major destination for foreign direct investments (FDI). At the end of 2013, the Eruopean Union as a whole was the first world region in terms total inward FDI stocks (OECD, 2014). However its importance has declined, especially after the crisis. While maintaining its primacy, the EU share of total inward FDI stocks declined from about 38% 38% at the end of 2007 to around 30% in 2014. Even more dramatic has been the fall in the FDI inflows share, from 40% to about 17% over the same period. As shown in the 2014 World Investment Report this meant that the EU from its top position in 2011 was overtaken by developing Asia and Latin America as a recipient of FDI inflows.

Despite these trends FDI inward positions steadily increased in the 2004-2012 period more than doubling from around 4.8 thousands to over 10 thousands EUR billions (chart 7). Flows presented a more volatile picture, increasing steadily in the 2004-2007 peaking at about 1.1 thousands EUR billions, but then decreasing every year, except 2011, to about 450-550 EUR billions (chart 8). The global financial crisis therefore heavily hit direct investments into EU companies, which is still very far from its pre-crisis levels.

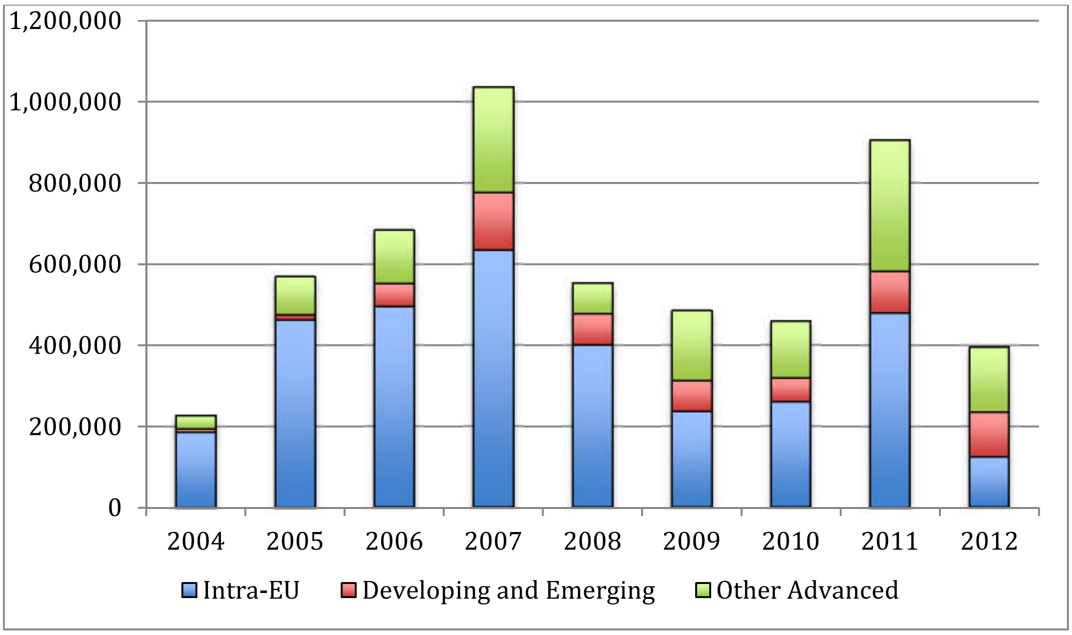
This project has received funding from the European Union's Seventh Framework Programme
for research, technological development and demonstration under grant agreement no 266800

Chart 7. EU-27 FDI Inward Positions – EUR Millions



Source: Author's calculations based on Eurostat[2]

Chart 8. EU-27 FDI Inward Flows – EUR Millions



Source: Author's calculations based on Eurostat

[2] While data for 2013 exist, they are likely to be still incomplete, as they show sizeable declines in both FDI flows and positions, which is at odds with the evidence of other sources (e.g. OECD, 2014). For this reason the analysis will be conducted using data only up to 2012. Emerging and developing countries is the sum of Africa, Asia (excl Japan), Latin America and Russia. Other Advanced countries are Northern America, European Free-Trade Agreement countries and Japan.

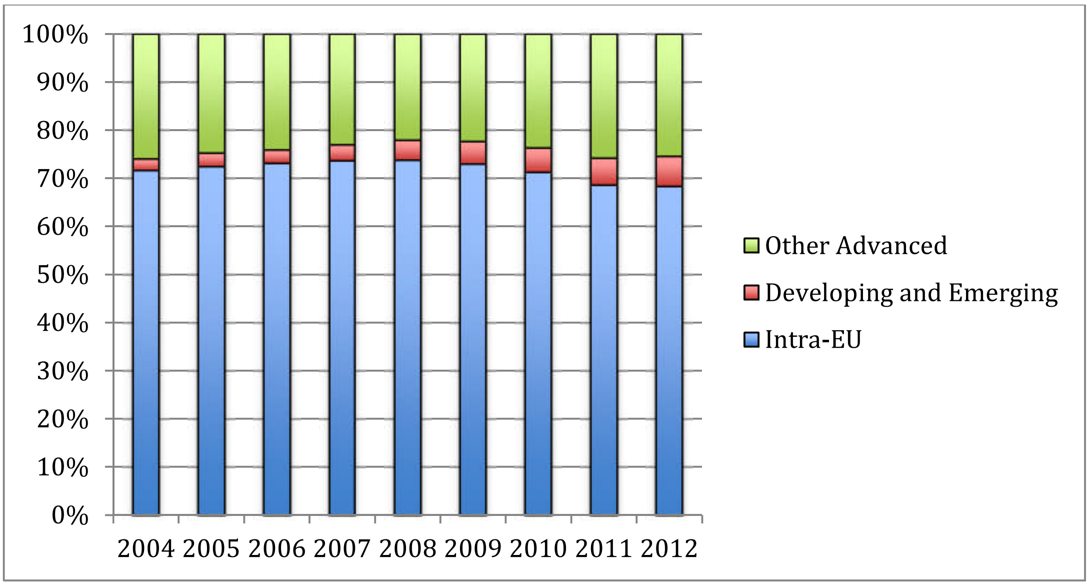
Most of EU members' inwards FDI are intra-EU, which constituted about 63% of FDI inflows to the EU on average in the 2004-2012 period according to UNCTAD (2014 p. 79). Eurostat data seem to broadly confirm this fact, as intra-EU 27 FDI constitute more than 66% of FDI inward positions throughout the whole period, and about 58.8% of FDI inflows, slightly less than the UNCTAD figure.

However, the importance of intra-EU FDI has declined over the same period. As shown in chart 9 in only four years since 2008, FDI inward positions declined from 66.6% to 62.3%. FDI inflows, as chart 10 shows, declined even more substantially: splitting up the period into two four years sub-periods gives an average of 70.6% for 2004-2007, and 44.9% for 2008-2012. This highlights how the global financial crisis and the Eurozone troubles had a sizeable impact mostly on intra-EU direct investment, which therefore account for most of the EU inward FDI decline. It also reflects a trend towards registering ownership of multinational corporations in off-shore financial centres, rather than within European fiscal jurisdictions.

Both non-European developed countries and developing and emerging countries have contributed to an increasing proportion of inward direct investments. Inflows from other advanced countries increased from 14.3% in 2004 to about 45.8% of total 2012 FDI inflows, whereas inflows from developing and emerging countries increased from 4.3% to 18.8% over the same period. Inflows from emerging and developing countries however increased much more substantially: in absolute terms the average inflows more than doubled in the 2008-2012 period, compared to the 2004-2007 period, while inflows from other advanced countries only increased by 30%.

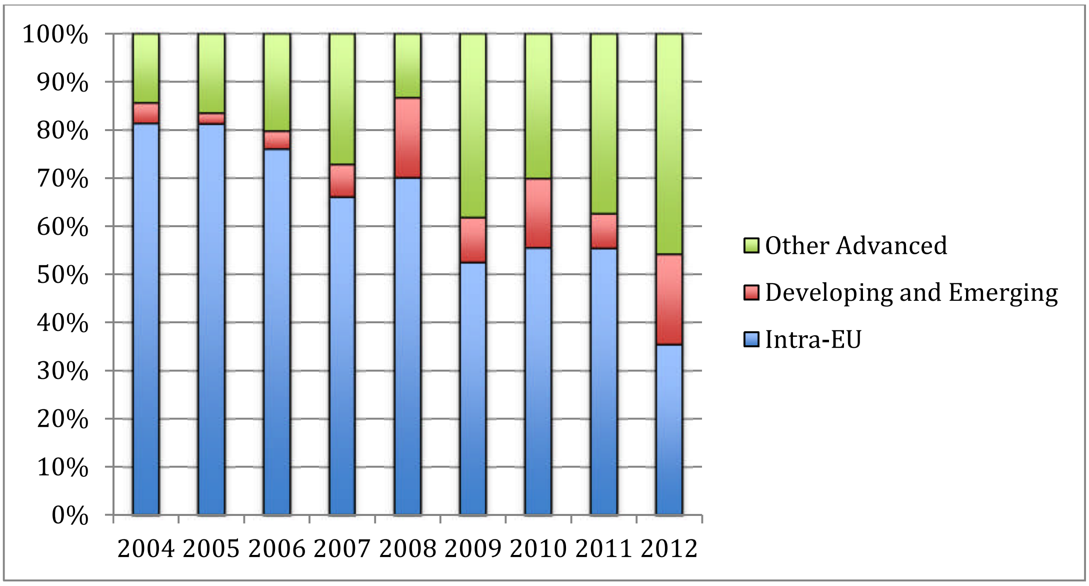
Similarly, the share of FDI inward stocks from non-EU advanced countries at the end of 2012 was very close to the levels of 2004 at 23-24%, decreasing in the first four years and increasing since 2008. Meanwhile the share of developing and emerging countries increased steadily throughout the period from 2.3% to 5.7%.

Chart 9. EU-27 FDI Inward Positions Shares



Source: Author's calculations based on Eurostat

Chart 10. EU-27 FDI Inward Flows Shares

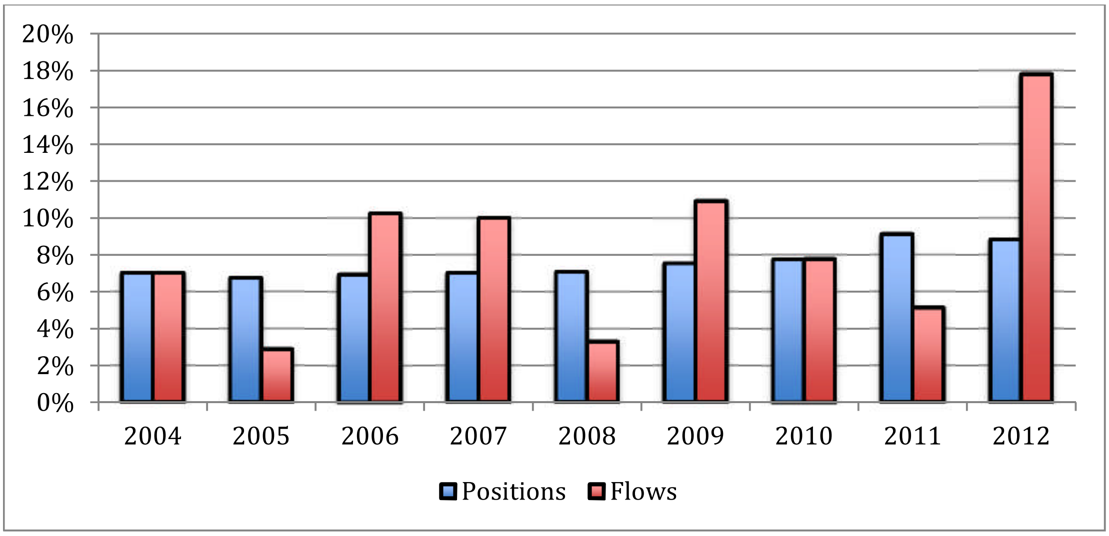


Source: Author's calculations based on Eurostat

Offshore financial centres count for about 8.3% of inwards FDI flows and 7.5% of inward stocks over the whole period. Without further specifications it is impossible to tell which proportion of this that intermediates flows from developing and emerging countries. However, these numbers are more or less in line with the global figures (UNCTAD, 2014, p.

3) and furthermore, offshore financial centres in Asia (e.g. Hong Kong or Singapore)[3] would be included in the count. It is therefore not implausible to assume that this would not result in substantial changes of the proportion of FDI from emerging and developing countries.

Chart 11. Offshore Financial centres – % of Total FDI



Source: Author's calculations based on Eurostat

Overall the balance of the evidence presented thus far suggests that developing and emerging countries have been increasingly been important as a source of direct investments to the EU. This seems to be especially important, since the decline of intra-EU FDI suggest a decreasing financing capacities by EU companies.

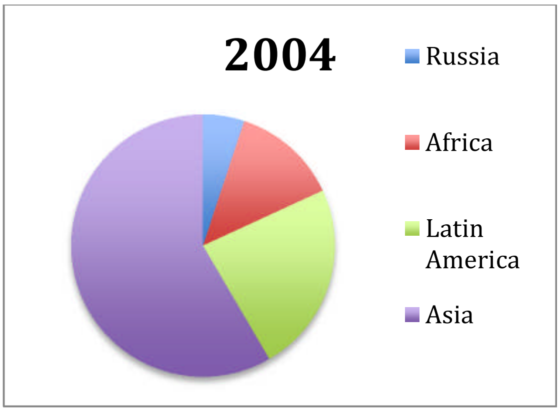
2.2 FDI from Developing and Emerging Countries by Region

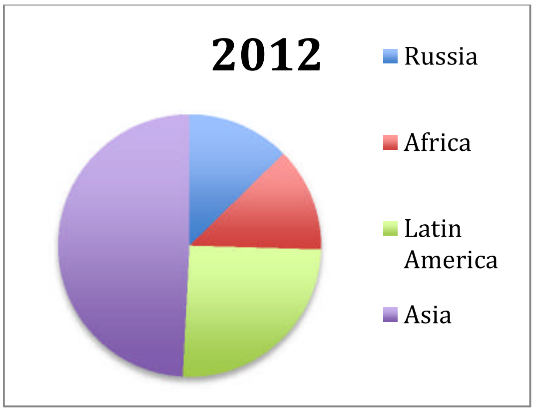
As chart 11 shows, there seems to be relative stability across the developing world from a regional point of view. Within the group, Asia was and remains the biggest investing region, as it accounts for about half of total inward FDI positions, although this is down from 58% in

[3] These countries are kept within the developing and emerging markets group because they are closely linked to their neighbouring developing and emerging countries. Hong Kong for example is the top destination of Chinese outward FDI, but it is likely that an important part of this only goes through the country to other destinations across the world (Salidjanova, 2011).

2004. The share of Africa and Latin America has not changed much, respectively at 13% and 23-25% in the same period. The importance of Russia increased from about 5% to 13%.

Chart 12 – Emerging and Developing Countries FDI position in the EU, Regional Shares

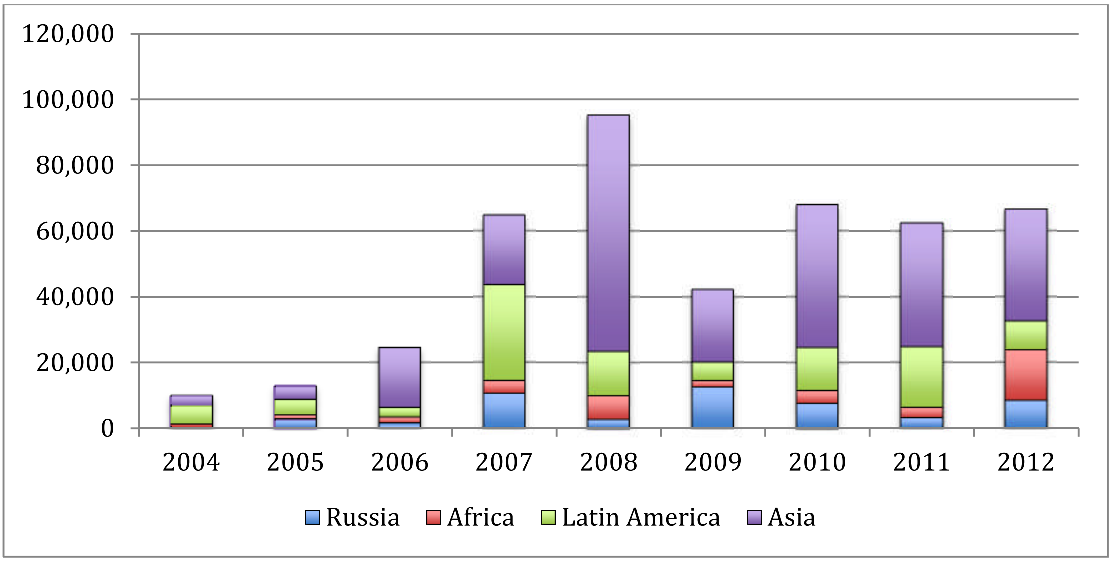




Source: Author's calculations based on Eurostat

Flows data by and large present the same picture, as shown in chart 12. Shares are relatively volatile, but overall there is no clear trend in the relative importance of different regions, except a more sizeable presence of Russia. Even in absolute terms the total sum of FDI inflows have been relatively stable since 2009, at a level just above 60 EUR millions. However it is important to note that while FDI since 2009 have been higher than in the pre-crisis period on average, they have yet to reach the pre-crisis peaks.

Chart 12. Emerging and Developing Countries FDI Flows to the EU – EUR millions



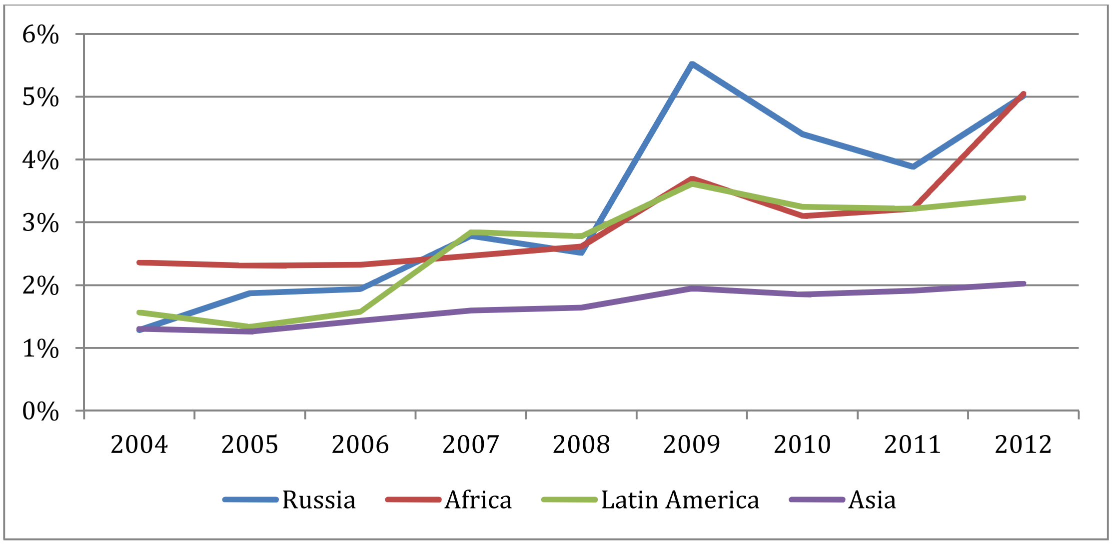
Source: Author's calculations based on Eurostat

To get a sense of the importance of FDI to Europe for each of the regions, chart 13 scales FDI positions by GDP. This proportion grew for all the regions, in line with the growing foreign investments from the developing world as a whole. Asia however has a lower share than the other developing regions. Partially, this might be the result of their very high growth rates, thus inflating the denominator of the ratios. However it is likely that this indicates that countries that regional proximity, as well as cultural and/or political ties to Europe results in a higher proportion of FDI allocated to European Countries.

This is confirmed in chart 14, where FDI to the EU are shown as a proportion to total external FDI holdings. Latin America and Africa invest in the EU a much higher proportion of their FDI than Asia[4]. Over time however these proportions have grown in Latin America, from 20% to about 40% of total outward FDI and Russia from 8% to 25%, whereas in Asia and Africa they have not substantially changed since 2004.

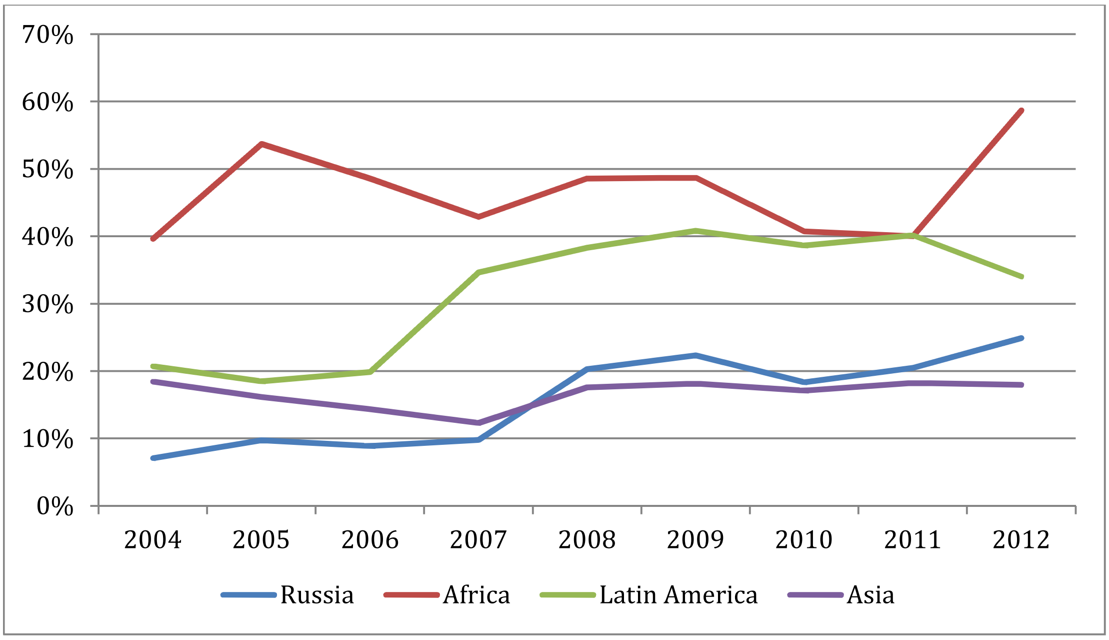
[4] Russia is a peculiar case, as data from Eurostat give a very different indication than data from Russian sources and UNCTAD. This will be further explored in the next section.

Chart 13. FDI to EU – % GDP



Source: Author's calculations based on Eurostat, Economist Intelligence Unit, and IMF Exchange Rate Report

Chart 14. FDI to EU – % Total FDI



Source: Author's calculations based on Eurostat, UNCTAD, and IMF Exchange Rate Report

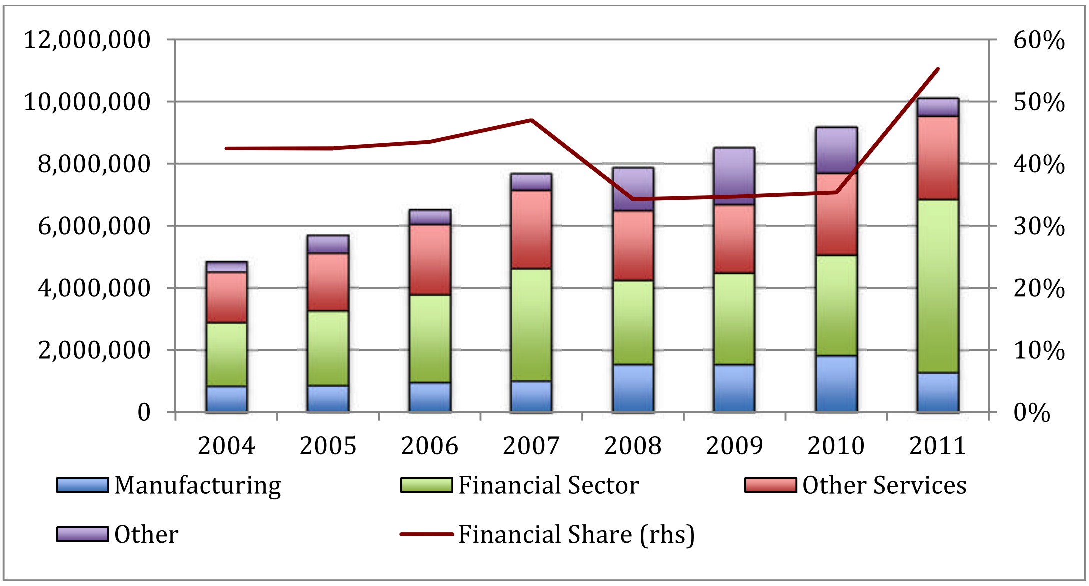
FESSUD
This project has received funding from the European Union's Seventh Framework Programme for research, technological development and demonstration under grant agreement no 266800

In sum it appears that overall the developing regions invest a relatively stable proportion of the their FDI to Europe. Differences in across regions exist, with some countries investing more, or a growing proportion of their FDI to Europe. However, it looks like much of the increase in FDI from developing countries follows the overall expansion of their economy and openness in terms of outward direct investments.

2.3 FDI by sector of destination

The breakdown of inward FDI by sector, as Chart 15 and 16 show, of destinations reveals the dominance of the services sector, and the financial sector in particular. On average in the 2004-2011 period, slightly above 70% of total inflows and inward positions are allocated to the services sector. More than two thirds of this is allocated to the financial sector, which alone constitutes about 42% of total inward positions and 45% of total inflows on average over the period. By contrast manufacturing constitutes a declining share of inwards FDI, accounting for about 16-17% of the total.

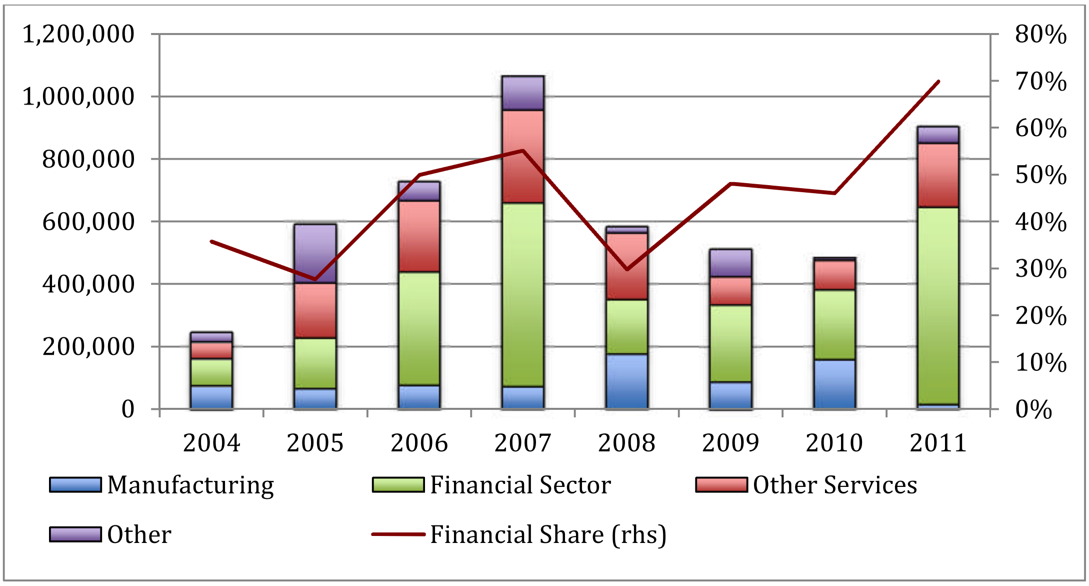
Chart 15. FDI Inwards Positions by Sector – EUR millions



Source: Author's calculations based on Eurostat[5]

[5] Other includes: agriculture, mining, electricity and gas provision, and unallocated FDI.

Chart 16. FDI Inflows by Sector – EUR Millions



Source: Author's calculations based on Eurostat

Unfortunately there is no data for the investing regions with sectoral breakdowns. Therefore we will rely on the information of the following sections about individual countries as an indicator of the sectoral allocation of developing and emerging economies

2.4 Summary

In sum, FDI to Europe have been declining since the crisis, mostly due to a fall in intra-EU FDI. On the other hand FDI from developing countries have been increasing, so that their importance as a source has been increasing. This seems to be mostly the result of their increasing outward orientation and their fast economic growth, as the overall picture does not show a growing allocation to Europe as a destination for direct investments.

Insofar as emerging and developing economies are going to experience higher levels of economic growth compared to developed and especially European countries, these trends are likely to continue. Therefore these countries could contribute to the economic development of Europe in the coming years. Much will however depend on the type of direct investment they undertake. This will be the purpose of the next section, focusing on major emerging economies, the BRIC countries.

This project has received funding from the European Union's Seventh Framework Programme for research, technological development and demonstration under grant agreement no 266800

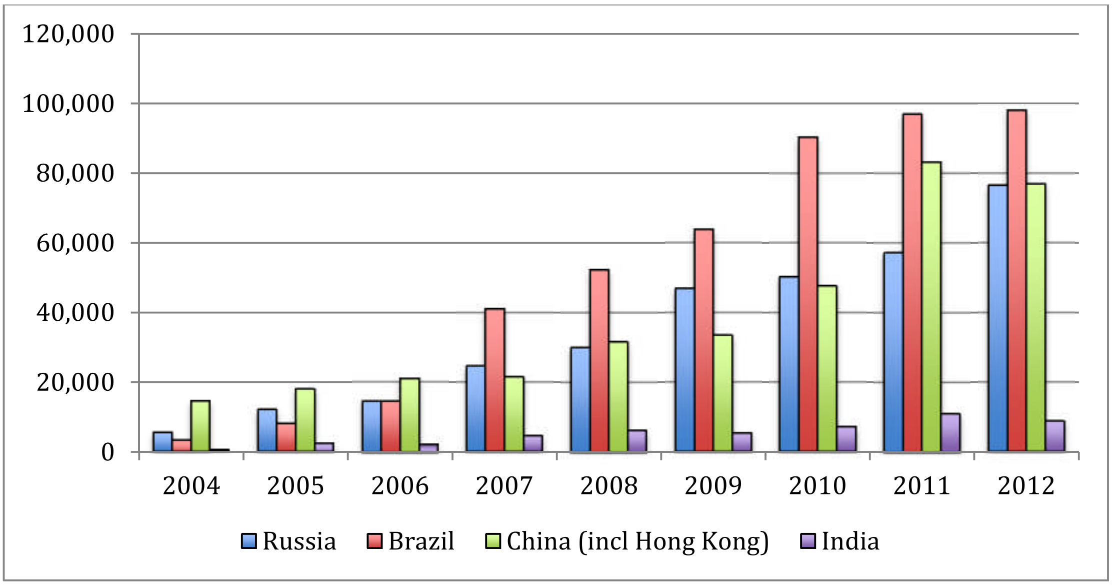
3 The BRIC Countries

FDI from Brazil, India, Russia and China have increased very quickly over the past 15 years. According to UNCTAD data, FDI outward stocks increased about four-fold between 2004 and 2013 in Brazil China[6] and Russia, and by more than 15 times in India, which started from a much lower level.

3.1 FDI from BRIC: overview

As Chart 17 shows, FDI to Europe have experienced an even more dramatic rise. Between 2004 and 2013 Chinese positions increased over five-fold, Russian by 13 times, Indian by 15 times, and Brazilian positions by almost 30 times. Brazil has been the top investing country since 2007, with Russia and China as closed seconds, whereas India's FDI are considerably smaller. As Chart 18 shows, in line with the results of the previous sections, FDI from the BRIC countries have not yet reached their pre-crisis levels of 2007.

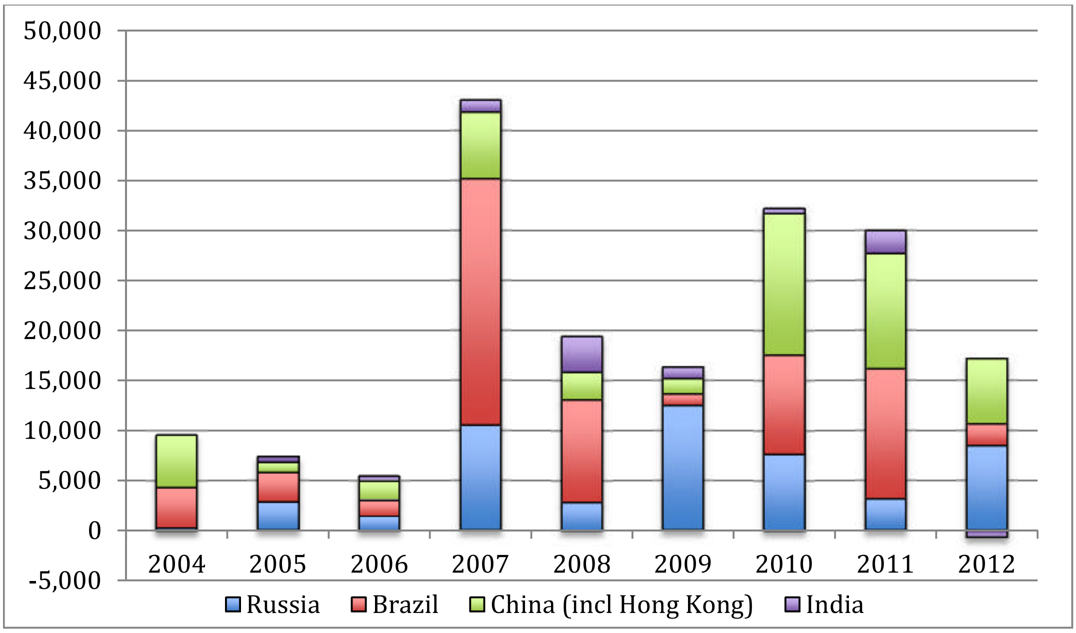
Chart 17. FDI Positions from BRIC Countries to EU-27 – EUR Millions



Source: Author's calculations based on Eurostat

[6] All figures for China include Hong Kong as in the previous section. This is because a great deal of Chinese outward direct investment goes through Hong Kong, as discussed.

Chart 18. FDI Flows from BRIC Countries to EU-27 – EUR Millions

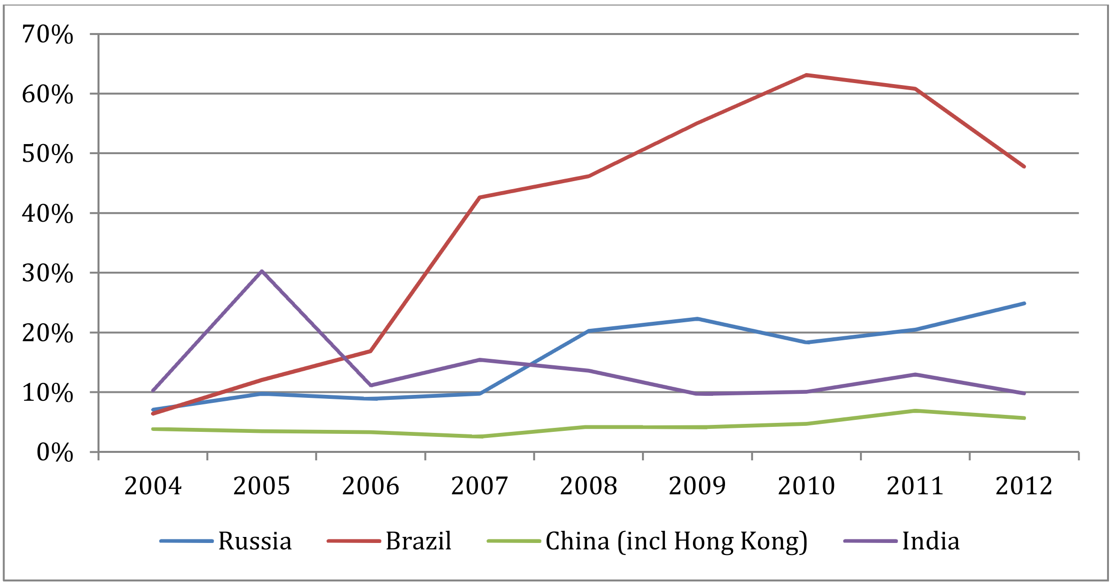


Source: Author's calculations based on Eurostat

Also in line with the previous section is the observation, as shown in Chart 19, that FDI to Europe have been a relatively stable proportion of total outward FDI: Russia and especially Brazil have invested a growing proportion of their FDI to Europe[7], whereas the proportion for China and India have not significantly changed since 2004. As these figures are remarkably similar to those shown in chart 14, it is likely that the BRIC countries are systemically important within their respective regions, therefore driving the regional trends.

[7] Using bilateral data from UNCTAD, which in turn derive from data from the Russian Central Bank, results substantially upwards the figures for Russia: in 2012 almost 68% of FDI would be allocated to EU countries, almost half of which to Cyprus. Eurostat data are preferred for two reasons. First, they ensure the consistency of data sources. Secondly, the very high figure for Russia may actually reveal the the "round-trip" FDI that goes from Russia to Russia through Cyprus (Ledyaeva et al., 2013) for tax and other purposes.

Chart 19. FDI Positions From BRIC Countries to EU-27 – Share of Total Outward FDI

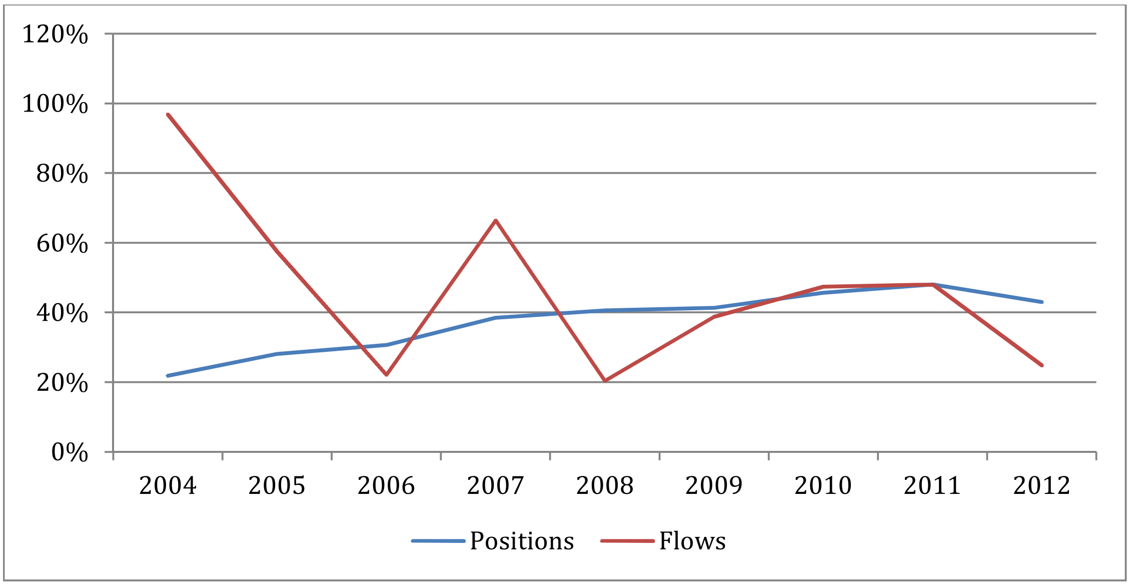


Source: Author's calculations based on Eurostat, UNCTAD and IMF Exchange Rate Report

This is confirmed in Chart 20, which shows how the BRIC have accounted for a sizeable and increasing proportion of Developing and Emerging Countries outward FDI Europe. The proportion of positions has grown steadily from about 20% in 2004 to almost half of the total in 2011, while flows oscillated around an average of about 47%. Focusing on the BRIC countries therefore allows to capture an important and potentially representative snapshot of developing and emerging countries direct investment activities.

This project has received funding from the European Union's Seventh Framework Programme
for research, technological development and demonstration under grant agreement no 266800

Chart 18. FDI Positions From BRIC Countries to EU-27 – Share of Total FDI Positions from Developing and Emerging Countries



Source: Author's calculations based on Eurostat

3.2 FDI from BRICS characteristics

Aside from balance of payments figures, it is useful to look at Eurostat Structural Business Statistics, which have indicators for non-financial firms operating in the EU. As shown in Table 1[8], BRIC countries, like all foreign investors, tend to invest in bigger and more productive firms than those domestically owned by the recipient countries.

However the results present some elements of difference compared to the previous section. India, which is by far the smallest investor in monetary terms, controls firms that at the aggregate level have the highest value added, and value added per enterprise. Brazil on the other hand, while being the top investor in monetary terms, controls very few enterprises in Europe producing on aggregate much less value added. Finally, Russia controls relatively smaller and less productive firms than the other four countries.

It would therefore seem that the FDI from Brazil and Russia are less conductive to generate value added in Europe. As shown in the last column of the table, scaled by FDI positions value added differ dramatically across the BRIC: while India and china added

[8] 2009 and 2010 are the only two years for which data for these countries are reliable and reasonably complete.

value for 0.14 – in line with the global average - and 1.22 euros per euro of inward investment positions, for Russia the ratio goes down to 0.042 and for Brazil to even less at 0.0007.

Table 1. Business Statistics

	No. of Enterprises		No. Of Employees		Value Added (EUR mill)	
	2009	*2010*	*2009*	*2010*	*2009*	*2010*
Russia		1,777	50,195	45,973	1,625.58	2,100.3
Brazil	151	245	19,729	21,056		600
China	2,446	3,064	87,508	99,208	5,680.93	6,531.6
India	820		107,908	121,170	5,323.7	8,894.0
Reporting country	18,189,279	20,063,436	109,067,062	111,154,451	4,291,639	4,554,237
Total	18,425,453	20,307,663	126,941,664	129,467,943	5,468,372	5,893,366
Total Foreign	236,174	244,227	17,874,602	18,313,492	1,176,732	1,339,129
	Av. Employees per enterprise		**Av. Value added per enterprise**		**Value Added/FDI Positions**	
	2009	*2010*	*2009*	*2010*	*2010*	
Russia		25.87		1.18	0.042	
Brazil	130.66	85.94		2.45	0.0007	
China	35.78	32.38	2.32	2.13	0.14	
India	131.6		6.49		1.22	
Reporting country	6	5.54	0.24	0.23		
Total	6.89	6.38	0.3	0.29		
Total Foreign	75.68	74.99	4.98	5.48	0.15	

Source: Author's calculations based on Eurostat

Note: Excludes Financial and Insurance Activities

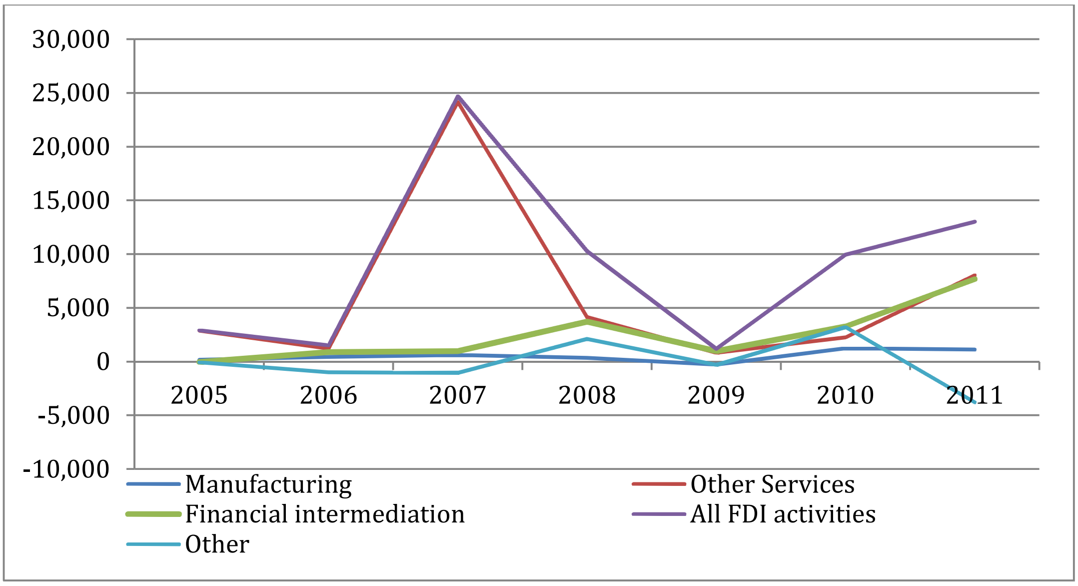
This project has received funding from the European Union's Seventh Framework Programme for research, technological development and demonstration under grant agreement no 266800

Chart 19 helps rationalising these facts. The Majority of Brazilian FDI to Europe is allocated to financial sector activities. In 2011 these account for about 80% of total FDI positions. Furthermore, as chart 20 shows, the financial sector has been the biggest recipient of FDI flows since 2008. Indeed this explains why the number of Brazilian controlled firms is so small compared to their direct investment, and their value added so low.

Chart 19. FDI Positions From Brazil to EU-27 – % by Sector

Source: Author's calculations based on Eurostat

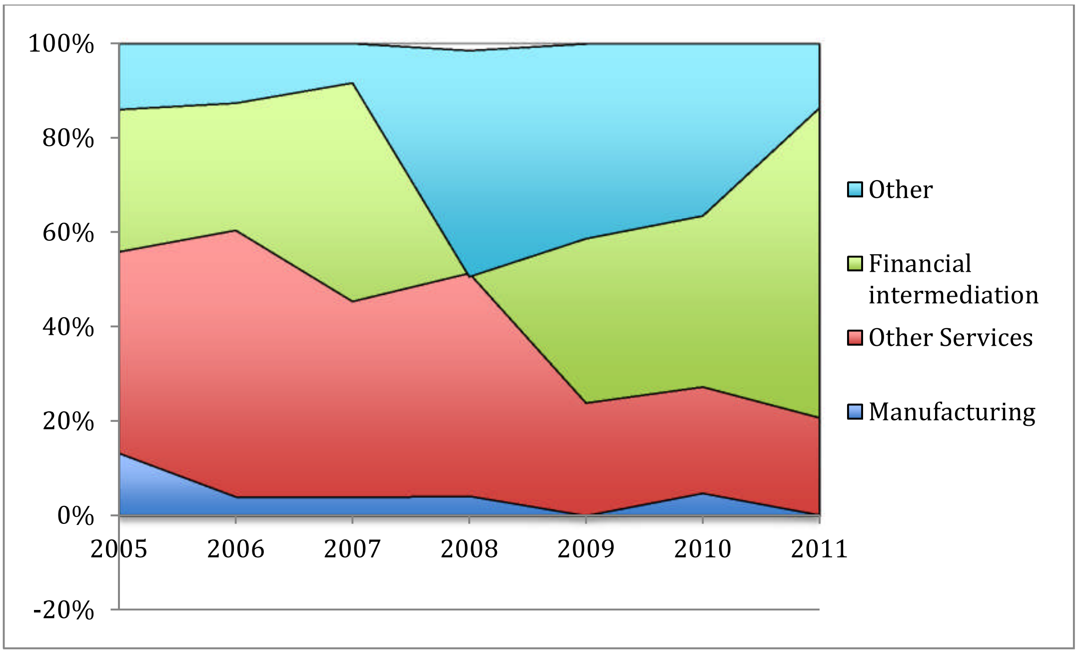
Chart 20. FDI flows From Brazil to EU-27 – by Sector EUR millions



Source: Author's calculations based on Eurostat

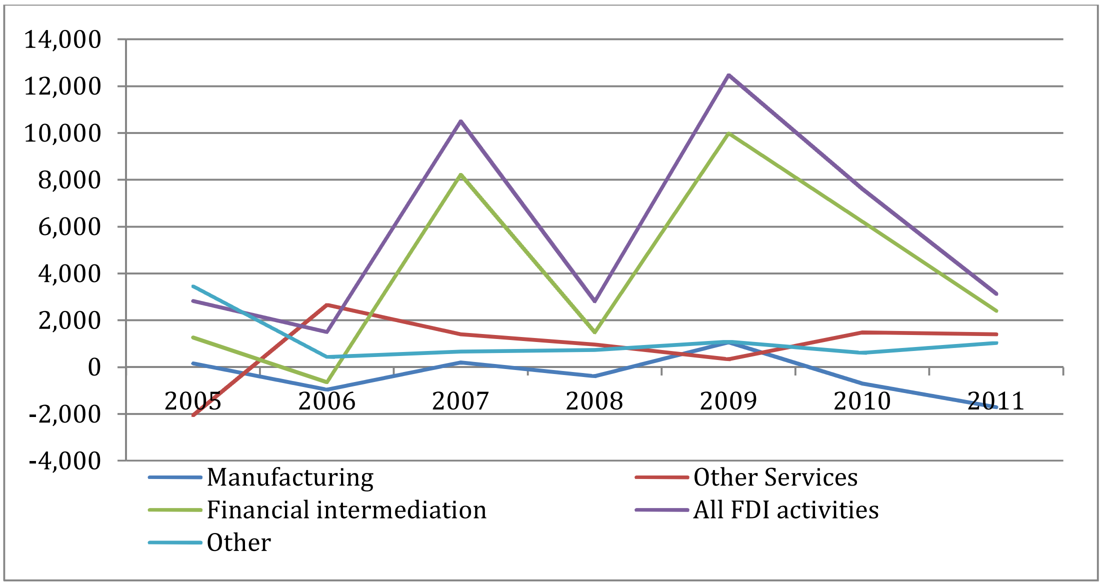
Russia has had over the period a higher proportion of "other" FDI holdings, partially reflecting data classification issue, but also a higher proportion dedicated to electricity and gas provision companies (Chart 21). Financial intermediation still represented a key sector, at about over 30% of total holdings since 2005 (except in 2008), reaching 68% in 2011. Moreover total FDI flows to the EU, as Chart 22 shows, have been driven by flows to the financial sector. Once again this explains the relatively low-value added figures for Russian FDI shown by Table 1.

Chart 21. FDI Positions From Russia to EU-27 – % by Sector



Source: Author's calculations based on Eurostat

Chart 22. FDI flows From Russia to EU-27 – by Sector EUR millions



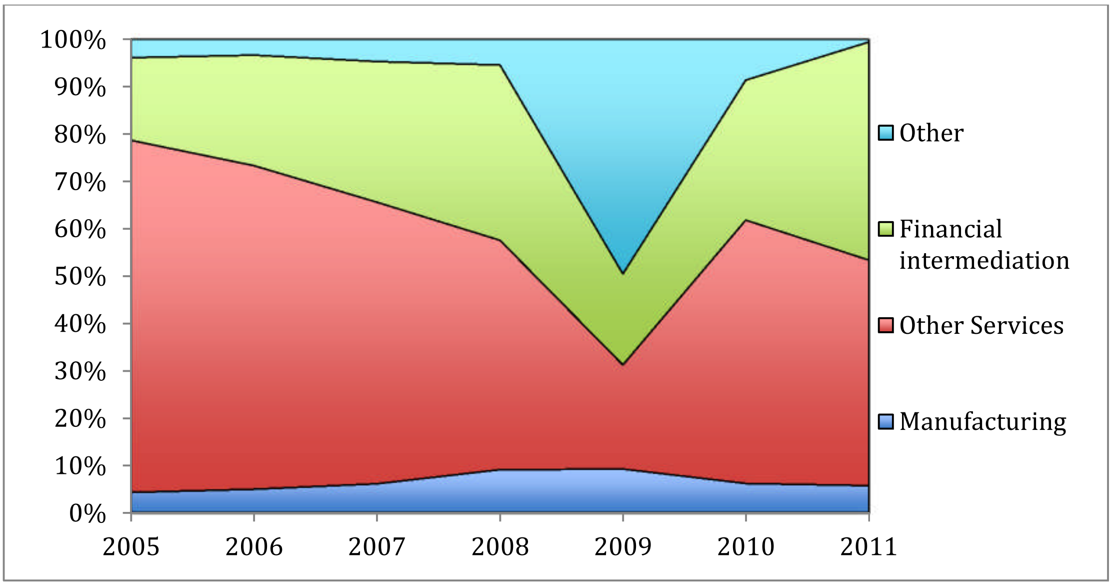
Source: Author's calculations based on Eurostat

As Chart 23 shows, China invests between 20% and 40% into financial sector companies, much less than Brazil and Russia but also less than the total FDI to EU, as it was shown in

This project has received funding from the European Union's Seventh Framework Programme for research, technological development and demonstration under grant agreement no 266800

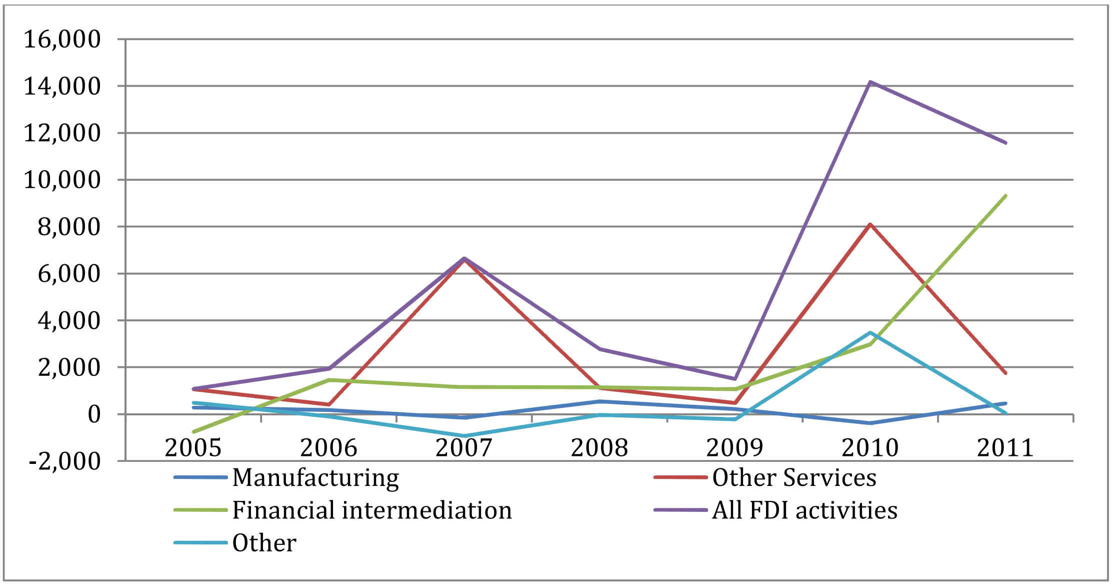
Chart 15. However FDI flows to the financial sector haeve been rising over time, representing the major component on 2011.

Chart 23. FDI Positions From China to EU-27 – % by Sector



Source: Author's calculations based on Eurostat

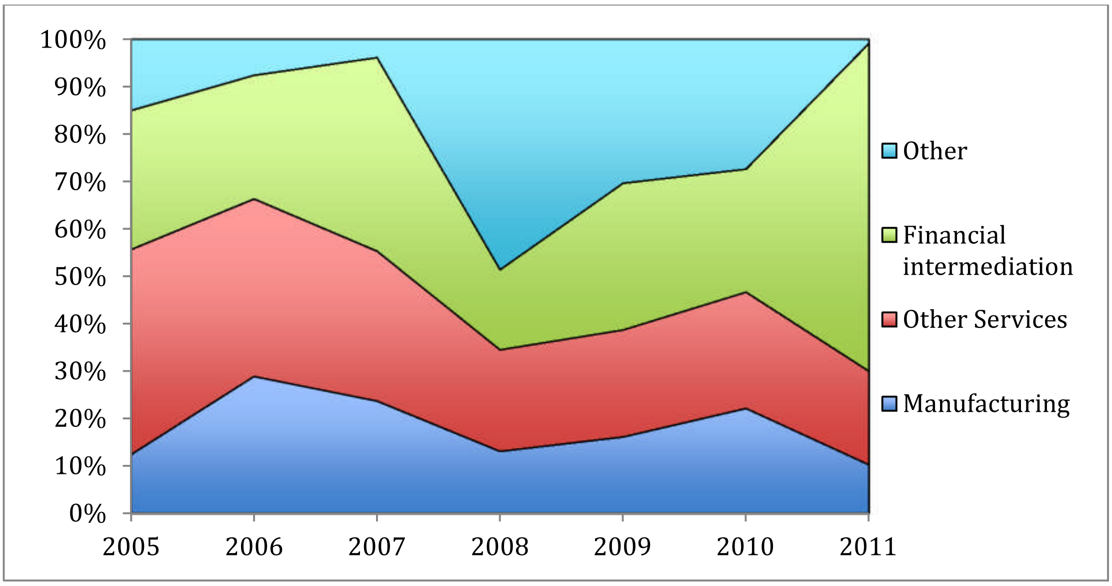
Chart 24. FDI flows From China to EU-27 – by Sector EUR millions



Source: Author's calculations based on Eurostat

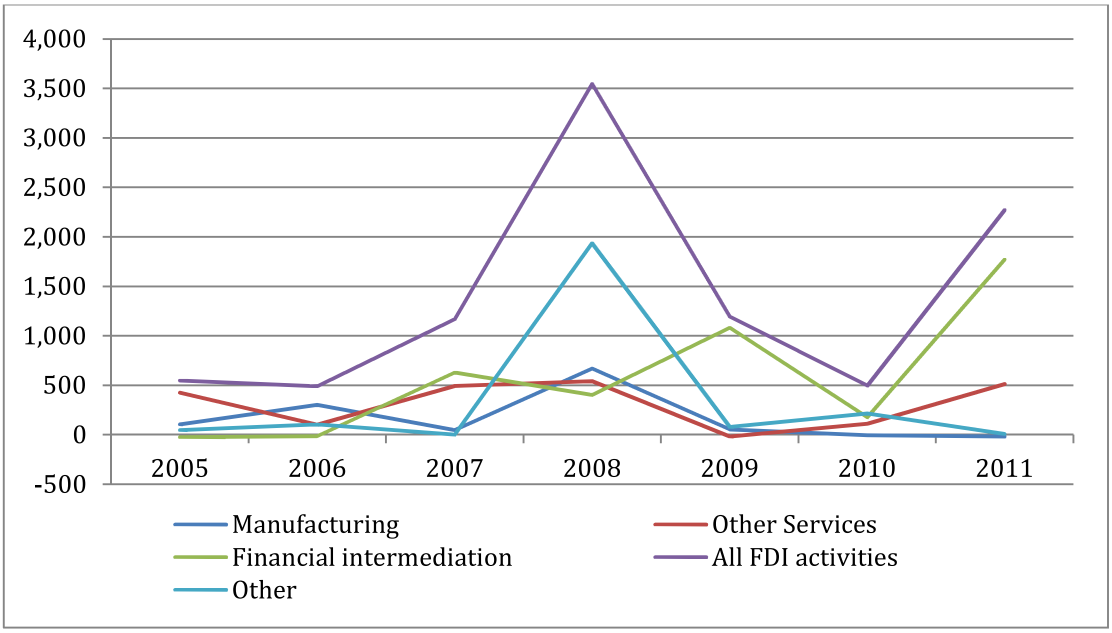
India, as chart 25 shows, is the only BRIC that invests a sizeable portion of its FDI into manufacturing, and in general has a balanced EU-FDI portfolio across sectors. Although the weight of the financial sector has been on the rise since the global financial crisis - this is especially clear when looking at FDI flows, which have been dominated by financial sector flows since 2009 – manufacturing remains as high as 15% much higher than the average for FDI and the other BRIC. Nevertheless, given these allocations it is not surprising to see that India has the highest value added across the BRIC and above average value-added per enterprise on their FDI.

Chart 25. FDI Positions From India to EU-27 – % by Sector



Source: Author's calculations based on Eurostat

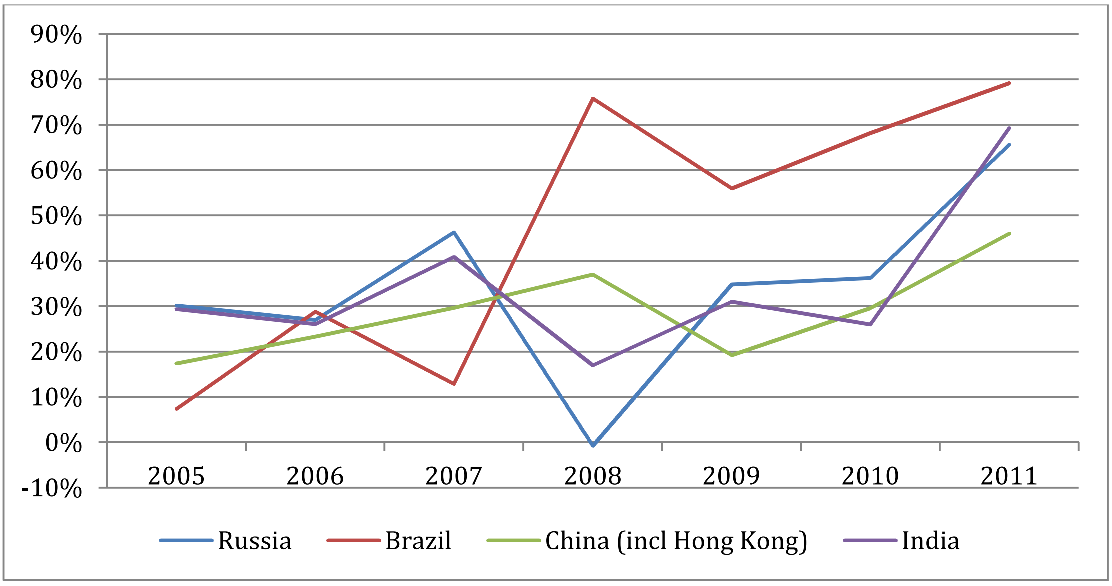
Chart 26. FDI flows From India to EU-27 – by Sector EUR millions



Source: Author's calculations based on Eurostat

Despite the important differences highlighted thus far, clearly the importance of the financial sector within the BRIC FDI to Europe is on the rise for all these countries, as clearly shown in chart 27.

Chart 27. Financial sector FDI – % of total



Source: Author's calculations based on Eurostat

3.3 BRICs FDI to Europe: concluding remarks

This section has provided an overview of the FDI from BRIC countries to Europe. BRIC are key sources of FDI within the developing and emerging countries category, representing almost half of the total in recent years. Within the group there are however differences. Brazil and Russia have similar investing patterns. They allocate a high proportion and growing of their FDI in Europe – also similar in absolute monetary terms. They also both invest a very proportion to the financial sector, thus making their FDI concentrated in low value added firms. At the opposite end is India, investing a declining proportion of their FDI to Europe, with a relatively high proportion to manufacturing, and high value added. China has the lowest allocation to Europe across the BRICs, and the sectoral allocation and structural features of its FDI are very much in line with the global FDI to EU figures.

It would therefore seem that there is a negative correlation[9] between the importance of the financial sector and the value-added performance of the BRIC's FDI. Moreover Brazil and Russia, which have higher allocations to Europe, invest more into the financial sector than India and China. Given this and the increasing trend in allocation to financial sector activities overtime by all countries, it would seem that BRIC FDI may not substantially contribute to provide finance to high value-adding firms. Insofar as the BRICs are representative for the developing and emerging countries group, this would imply that, despite their growing importance as investor countries, the scope for generating economic development from FDI to EU from the developing world is likely to be small.

This is consistent with the idea that BRIC countries invest abroad for reasons other than generating high value added. First of all, emerging and developing countries, should, in theory, have greater opportunities domestically to invest in high-value added activities. Moreover, the existing literature suggest that BRIC based companies mostly invest abroad to access European markets and therefore open up new channels through which sell their products (Clegg and Voss, 2012; Holtbrügge and Kreppel, 2012). Given these trends, it is not

[9] With these few observation it is impossible to meaningfully prove the statistical significance of such a correlation.

This project has received funding from the European Union's Seventh Framework Programme for research, technological development and demonstration under grant agreement no 266800

surprising that their focus is on the services sector, and the financial sector in particular, which may facilitate their access to the European markets more than manufacturing activities.

This project has received funding from the European Union's Seventh Framework Programme for research, technological development and demonstration under grant agreement no 266800

4 Conclusion

Capital inflows from the developing countries into the European Union are the flows that create and renew the debt structures that link the developing countries with the EU. Some of these debt structures in the form of debt obligations, denominated in Euros, or to EU official, multilateral or private sector creditors of governments and the private sector in developing countries. But they are also assets and companies in the EU owned by residents of the developing countries, emerging markets, and off-shore financial centres frequently located in less developed countries. For convenience therefore, capital inflows into the EU may be classified as holdings of European currency reserves by governments of developing countries and emerging markets; portfolio investment in EU capital markets, including holdings of European assets by Sovereign Wealth Funds in developing countries and emerging markets that are the subject of the companion report of the Deliverable 6.05; and foreign direct investment (FDI) in the EU from developing and emerging markets.

These debt and claim structures are complex and clearly go beyond holdings of EU bank deposits and financial assets as a 'hedge' against debts and owed to EU creditors. They also reflect the limited capital investment absorption capacity of many commodity-exporting countries in the Middle East where Sovereign Wealth Funds are based. This last is also a factor in the rise of multinational corporations based in emerging markets but active in the EU. The steel company Arcelor Mittal is the largest steel producer in the EU, and is financed in the EU, but started as FDI from India, with the purchase of European steel companies by Lakshmi Mittal. However, what is surprising is the extent to which companies from large emerging markets with substantial development potential, most notably the so-called BRIC countries (Brazil, Russia, India and China), are investing in Europe. In the final part of this report it was shown how a growing share of this FDI is in the financial sector. A striking finding is the low value added of much FDI from the largest emerging markets of Brazil, Russia, India and China. This would be consistent with a view that such FDI gives limited support to manufacturing in Europe.

5 Bibliography

Chinn, M. and Frankel, J. (2005) *Will the Euro Eventually Surpass the Dollar as Leading International Reserve Currency?*, Working Paper, National Bureau of Economic Research.

Clegg, J. and Voss, H. (2012) *Chinese Overseas Direct Investment in the European Union*, Europe China Research and Advice Network.

ECB (2014) *The International Role of the Euro*, European Central Bank.

Economist (2011) 'Climbing Greenback Mountain', *The Economist* (24 September 2011).

Gammeltoft, P. (2008) 'Emerging Multinationals: Outward FDI from the BRICS Countries', *International Journal of Technology and Globalisation*, **4**, 5–22.

Gourinchas, P.-O. and Rey, H. (2005) *From World Banker to World Venture Capitalist: US External Adjustment and the Exorbitant Privilege*, Working Paper, National Bureau of Economic Research.

Habib, M. M. (2010) *Excess Returns on Net Foreign Assets: The Exorbitant Privilege from a Global Perspective*, Working Paper Series, European Central Bank.

Holtbrügge, D. and Kreppel, H. (2012) 'Determinants of Outward Foreign Direct Investment from BRIC Countries: An Explorative Study', *International Journal of Emerging Markets*, **7**, 4–30.

Lane, P. R. and Milesi-Ferretti, G. M. (2007) 'The External Wealth of Nations Mark II: Revised and Extended Estimates of Foreign Assets and Liabilities, 1970-2004', *Journal of International Economics*, **73**, 223–250.

Ledyaeva, S., Karhunen, P. and Whalley, J. (2013) *Offshore Jurisdictions (including Cyprus), Corruption Money Laundering and Russian Round-Trip Investment*, Working Paper, National Bureau of Economic Research.

Obstfeld, M. (2010) 'Expanding Gross Asset Positions and the International Monetary System', *Proceedings - Economic Policy Symposium - Jackson Hole*, 463–478.

OECD (2014) *FDI in Figures, 2014*, Organisation for Economic Co-operation and Development.

Papaioannou, E. and Portes, R. (2008) *The International Role of the Euro: A Status Report*, European Economy - Economic Paper, Directorate General Economic and Financial Affairs (DG ECFIN), European Commission.

Pineau, G. and Dorrucci, E. (2006) *The Accumulation of Foreign Reserves*, Occasional Paper Series, European Central Bank.

Salidjanova, N. (2011) *Going Out: An Overview of China's Outward Foreign Direct Investment*, USCC Staff Research Report, U.S.-China Economic and Security Review Commission.

Sauvant, K. P. (2005) 'New Sources of FDI: The BRICs - Outward FDI from Brazil, Russia, India and China', *Journal of World Investment & Trade*, 6, 639.

UNCTAD (2014) *Investing in the SDGs: An Action Plan*, World Investment Report, United Nation Conference on Trade and Development.

Financialisation, Economy, Society and Sustainable Development (FESSUD) is a 10 million euro project largely funded by a near 8 million euro grant from the European Commission under Framework Programme 7 (contract number : 266800). The University of Leeds is the lead co-ordinator for the research project with a budget of over 2 million euros.

THE ABSTRACT OF THE PROJECT IS:

The research programme will integrate diverse levels, methods and disciplinary traditions with the aim of developing a comprehensive policy agenda for changing the role of the financial system to help achieve a future which is sustainable in environmental, social and economic terms. The programme involves an integrated and balanced consortium involving partners from 14 countries that has unsurpassed experience of deploying diverse perspectives both within economics and across disciplines inclusive of economics. The programme is distinctively pluralistic, and aims to forge alliances across the social sciences, so as to understand how finance can better serve economic, social and environmental needs. The central issues addressed are the ways in which the growth and performance of economies in the last 30 years have been dependent on the characteristics of the processes of financialisation; how has financialisation impacted on the achievement of specific economic, social, and environmental objectives?; the nature of the relationship between financialisation and the sustainability of the financial system, economic development and the environment?; the lessons to be drawn from the crisis about the nature and impacts of financialisation? ; what are the requisites of a financial system able to support a process of sustainable development, broadly conceived?'

This project has received funding from the European Union's Seventh Framework Programme
for research, technological development and demonstration under grant agreement no 266800

THE PARTNERS IN THE CONSORTIUM ARE:

Participant Number	Participant organisation name	Country
1 (Coordinator)	University of Leeds	UK
2	University of Siena	Italy
3	School of Oriental and African Studies	UK
4	Fondation Nationale des Sciences Politiques	France
5	Pour la Solidarite, Brussels	Belgium
6	Poznan University of Economics	Poland
7	Tallin University of Technology	Estonia
8	Berlin School of Economics and Law	Germany
9	Centre for Social Studies, University of Coimbra	Portugal
10	University of Pannonia, Veszprem	Hungary
11	National and Kapodistrian University of Athens	Greece
12	Middle East Technical University, Ankara	Turkey
13	Lund University	Sweden
14	University of Witwatersrand	South Africa
15	University of the Basque Country, Bilbao	Spain

Published in Leeds, U.K. on behalf of the FESSUD project.