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FOREIGN DIRECT INVESTMENT: DIAGNOSIS AND PROPOSALS FOR A BRAZILIAN PUBLIC POLICY

Milton de Abreu Campanario [i]
Marcello Muniz as Silva [ii]
Milton de Freitas Chagas Junior [iii]
Leonel Cesarino Pessoa [iv]

The text is the part of public policy of a larger research project on Brazilian Outward Foreign Direct Investment - OFDI. The text analyses the viability to adopt policies to enhance FDI, particularly outward. Based on statistical data and on literature review, the policy agenda frames the underling questions surrounding the theme. There is not yet a theoretical framework to deal with emergent countries' FDI and related policies. There exist strong evidences that capital flows through FDI generate externalities in the following domains: macroeconomics, microeconomics and foreign relations particularly in areas related to industrial organization and innovation. The theoretical proposition is that international capital flows are compatible to monetary stability, commercial openness, investment promotion and industrial innovation policies. A better positioning of national enterprises internationally may result in growing partnership within the foreign environment. Brazil has not a set of policies to deal with inward and outward Brazilian FDI flows. These policies do not necessarily jeopardize macroeconomic policy and the related monetary and currency stabilization goals. It contends that FDI stimulus by means of public policies may contribute not just to a better competitiveness and innovation of Brazilian enterprises, but also assure a balanced growing and economic structural change.

Key-words: Brazilian Foreign Direct Investment- FDI, transnational corporations, foreign trade

[i] Universidade Nove de Julho - UNINOVE; Programa de Mestrado e Doutorado em Administração; macampanario@uol.com.br; Av. Francisco Matarazzo 612, Água Branca, São Paulo/SP.
[ii] Escola Politécnica - USP; Doutorando em Engenharia Naval; marcello_muniz@yahoo.com.br; Av. Prof. Luciano Gualberto 380, Cidade Universitária, São Paulo/SP.
[iii] Instituto Tecnológico de Aeronáutica - ITA; Doutorado em Engenharia Aeronáutica e Mecânica. miltonfc@uninove.br; Praça Marechal Eduardo Gomes 50, Vila das Acácias, São José dos Campos/SP.
[iv] Universidade Nove de Julho; Programa de Mestrado e Doutorado em Administração; lcpessoa2@uninove.br; Av. Francisco Matarazzo 612, Água Branca, São Paulo/SP.

1. Introduction

This article is the result of larger project on Brazilian Outward Foreign Direct Investment - OFDI published in a collection led by Fleury (2010). It deals specifically with the public policies that promote FDI, outward or inward. Campanario et al. (2010) first developed the arguments in a chapter of this collection. Now, after the crisis of 2008, new evidences, the contribution of colleagues (including the blind reviewers), new data and perspectives are best organized in this text.

FDI is the creation or expansion of a subsidiary company outside its country of origin through the acquisition by residents of one country (the source of capital) of assets belonging to residents of another country (the destination of the capital or the host country). Foreign Direct Investment – FDI associates strong increase in rates of foreign trade and the advancement of the process of internationalization of production and financial services. Thus, FDI involves a structured financial transaction, oriented to control production factors in a given host country. Finally, this subsidiary's objectives derive not only from the guidelines of the organizational structure of the company that makes the investment but also by public policies and macroeconomic environment.

From a strictly financial point of view, this type of transaction is an option (in many cases advantageous) to traditional means of loan or financing. Firms conducting FDI expect return (for a given level and degree of risk aversion) and of other sources of gain as technological spin offs or access to strategic assets. FDI does not contemplate merely the acquisition of a controlling stake in a company or business abroad. Unlike investment in financial portfolio (traded on organized markets like stock exchanges), FDI involves investment transactions tailored made, targeted to certain companies and specific sectors, with profile predominantly directed to long term, aiming gains that are of difficult measurement only in terms of financial calculation. In fact, the acquisition of real assets absorbs resources for the acquisition of inputs (machinery, equipment, facilities etc), use of working capital (needed to initiate and maintain an operation), among other expenses, exposing the investor to a series of risks (sovereign risk, exchange rate, etc.) in search of profits. Due to low liquidity and timing required for recovery of capital

allocated, the projects involve a high degree of uncertainty. Additionally, several studies indicate that FDI has significance that goes beyond rationality and the dynamics of private investment. In aggregate numbers, these transactions imply profound macroeconomic impacts on the real and monetary economy, profoundly affecting the process of economic growth and development. Not surprisingly, issues associated with the dynamics of the Balance of Payments, Current Account and Capital Account and its impact on the level of activity, investment, production volume and prices, exchange rates, interest rates and international reserves are object of heated political and economic discussions over the past years (SAUVANT et al., 2008).

New conceptions of public policy on this topic may be relevant in the following areas: (i) macroeconomic; and (ii) microeconomic (with emphasis on industrial organization and innovation) and (iii) foreign relations and trade. The proposition advanced here is that policies to strengthen the international capital flows might be viable under current conditions in Brazil. They would improve the competitiveness of Brazilian multinational companies as well as help to better regulate the fluctuations of the exchange rate, attract foreign savings and make the best of Brazilian foreign trade.

To address these issues, the study includes four sections besides this introduction. Section 2 presents a brief literature review, focusing on the modeling of foreign investment (notably the approaches "Ownership, location and internalization" – OLI and "Investment development path" - IDPath) and the role of FDI as an important factor for saving and investment. Section 3 presents the method of the study derived from the models discussed. As the process of internationalization of companies from developing countries is new, the phenomenon lacks a systematic theoretical treatment. The methodological foundations are exploratory, involving the analysis of macroeconomic statistics and survey of literature. The attempt is to summarize, relate and guide the construction of a framework that might support the public action in FDI. Section 4 presents a diagnostic on the insertion of active policies for Brazilian outward foreign direct investment – OFDI. Section 5 presents a set of reasoned proposals, contributing to the construction of OFDI policy debate in Brazil. Finally, section 6 presents the concluding remarks, framing the public policy proposals in the field of OFDI.

2. Summary of explanatory models of FDI

From the economic theory point of view, the phenomenon of FDI has been studied since the 1960s, particularly from the contributions of Hymer (1976), in the theory of industrial organization, and Dunning (1970; 1977; 1979) which writes in macroeconomics and microeconomics.

Countries seek to attract foreign investment guided by a variety of interests, but grounded in the idea of promoting economic growth through multiplier effects. The rationale of these interests are generating employment and income, bringing tangible assets such as physical capital and infrastructure, and intangible as knowledge, technologies, supplier networks, culture, among others [CASSON, 1983; TEECE, 1982).

Economic studies also address the macroeconomic effects of the entry of foreign resources in terms of the balance of macroeconomic aggregates, affecting variables such as savings, investment, interest rate and currency exchange. No conclusive statement is adherent to theories available (HELPMAN, 2006; and PAIN and WESUM, 2003). Caves (1971) states that the existence of FDI relates to differentiation and product innovation, the patented knowledge and barriers to entry for new firms. This approach also focuses on issues of trade-off between international trade and investment flows between countries. This is one of the special topics discussed by the International Monetary Fund (GHOSH et al., 2008). Based on these broad approaches, the aim of this work is to examine two major theoretical perspectives in order to create propositions about the case of OFDI from emerging countries: (i) the motivations and impacts of FDI on the microeconomic perspectives of markets and firms; (ii) macroeconomic restrains in the formation of savings and investment; and (iii) the policies that may fit to the Brazilian case.

What motivates FDI? The OLI paradigm (Ownership, Location & internalization) and the IDPath (Investment Development Path) are two strands of theoretical thought, created by John Dunning. As both approaches are closely related, an attempt of synthesis is undertake. Following Table 1, phase 1 of the OLI model, foreign investment is simply opportunistic, seeking to exploit

an asset available abroad, usually, a natural resource. In phase 2, there is an incipient convergence of interests of the company and the host country. To explore local markets, it is necessary that a series of requirements in the production chain be met, like searching for lower cost of infrastructure and transaction (including the tax area), more stable policies, suppliers and local labor market minimally organized. Phase 3 incorporates the flow of foreign capital as a more frequent practice of the markets. Flow of capital, inside and outside, is more intense, but still operating based on criteria of comparative advantages. That is, they take advantage of existing tangible assets with economies of scale. In Phase 4, it becomes more relevant the process of searching for competitiveness and efficiency gains. Scale in operations is achieved through innovative technology for processes, products and marketing, fixation of brand and increasing synergies in the supply and distribution chain and more emphasis on intangible assets. Finally, in phase 5, the level of investment reaches maturity and becomes one of the dominant elements of the economy. It surpasses in importance the dynamics of foreign trade, being a very relevant element that can react to the most different macroeconomic situations (interest and exchange rates) and its cycles. FDI will become a mechanism of control of the monetary stability and of market integration in global networks of supply and distribution.

By pointing to several simultaneous factors that contribute to the process of internationalization of investment, Dunning (2006) creates what is conventionally called "OLI Paradigm" or “Eclectic Paradigm”. The acronym OLI express the factors: "Ownership, Location & Internalization – OLI”. These factors are responsible for the globalization of enterprises by means of a movement that competes not only with the simple act of serving foreign markets through exports, but also replace efficiently export activities. When there are favorable return conditions, the company starts a strategy of **OWNERSHIP** of tangible and intangible assets (markets of factors, natural resources and capital, technology, etc.) inside and outside the country. Industrial production plants use these assets in multiple **LOCATIONS** around the globe. The “liabilities of foreignness” can be overcome. They consist of very different factors depending on the region or industry in question: firms operating in the oil sector have a completely different environment than high technology in different parts of the world, as claimed by Gray (2003).

This practice allows the company to buy strategic assets and use them in different regions outside its headquarters, expanding its operating capacity in scale or scope, depending on the situation of the production chain where it operates. The use of assets actually involves the opening of branches and is contributing to the **INTERNALIZATION** of production in the various regions (internalization), making from the activity of local production a substitute for the direct export from the head office (horizontal integration) or a mechanism to increase the export from the head office with local complementation (vertical integration).

Phases of IDP – OLI	Ownership	Location	Internalization
Phase 1: Opportunistic	High legal and institutional risk. Exploration contracts. High transaction costs. Value Rarity/Resource Base Value - RBV	Natural assets with high demand Scale of operation. Low production costs.	Exploitation of static comparative advantages (tangible assets).
Phase 2: Incipient	Incentive policies and investment attraction. Joint-ventures. Asset ownership and local supply.	Nascent Market Infrastructure. Less transaction costs. Labor market	Market penetration for local segment.
Phase 3: Practitioner	Appropriate policies. International tangible asset management.	Strong Market Systemic competitiveness.	Capital entry in open segments. Incipient capital outflows in competitive segments.
Phase 4: Competitor	Management of international, strategic tangible and intangible assets. Global technology and innovation. Scale and focus of production. Global business leadership.	Export platform. Capital Markets. Skilled labor. Differentiated Infrastructure. Logistics.	Increased inflow and outflow of capital. Dynamic comparative advantages (tangible and intangible assets)
Phase 5:	Greater mobility of capital.	Global Capital	Open Economy.

Dominant	Supply and global projects. Advanced technology in production, organization and market Efficiency and rationality in international management. Created Assets: brands, products, process and knowledge.	markets. Intangible Resources. Increased sensitivity to variables (interest and exchange rates) and economic cycles.	Dependence on created intangible assets. Complementarity with global trade. Supply and distribution chain in global networks

Table 1: Summary of IDPath and OLI. Integration model
Source: Formulated by the authors based on the Investment Development Path – IDPath and on the Paradigm of Ownership, Location and Internalization - OLI.

The influence of the OLI paradigm, along with other more specific contributions generate a classification of attractive factors for the internationalization process, greatly facilitating the research, such as that conducted by Tavares and Ferraz (2007), the survey by UNCTAD (2008), the collection of articles organized by Ramsey and Almeida (1999) and even the article by Coutinho et al. (2006). A schematized summary of these contributions is in Table 2.

Focus in critical variables	**Phases do IDPath - Cumulative**
Focus on Resources • Natural and unique. • Natural and complementary. • Infrastructure. • Logístic.	**Oportunistic** • Country receptor of specialized capital. • Exploration of tanglible assets • Static Comparative Advantages. • Units of resource extraction. • Sector infrastructure. • Value-rarity/RBV
Focus on Market (*market-seeking*) • Open Markets. • Chains of distribution. • Global and Regional Leadeship. • Comatible Income range.	**Incipient** • Country receptor: diversifFDI capital • Puplic Policies. • Market strategies. • Local income. • Selected segments.
Focus on efficency *(efficience seeking)* • Scale manufactoring.	**Praticant** • Host country and source capital

• Operations and Logistics. • Global management and learning. • Search for efficient infrastructure. • Supplies and distribution. • Broad Labor Market	• International asset management • Open public policies. • Global sector competitiveness. • Creation of intangible assets not imitable.-organization /RBV. • Labor market • First flows out.
Focus on created assets (*created asset*) • Globalization of the brand. • Technologies, patents and brands. • Formation of global suply and distribution networks. • Valeu Chains (*market affiliates*). • Picture: brand and values.	**Competitor** • Intense flows into and out. • Expansion of tanglible assets. • VRIO/RBV. • Dynamic comparative advantages. • QualifFDI Labor market • Differentiated infrastructure.
Jumping the barrier • Reduction of risk and uncertainty. • "Insecurity of being Foreigner". • Overcoming transaction costs. • Mobility of capital for input and output.	**Dominant** • Break boundaries and sensitivity to cycles and short-term economic policies • Building networks for global suply and distribution. • Flow of aditional capital to world trade.

Table 2: Summary of the OLI/IDPath, U e I Models.
Source: Prepared by the authors based on the OLI/IDP Paradigm and Models U e I.

Inward and outward FDI is progressively relevant to explain the dynamism and wealth of many countries and regions, being measured in National Accounting (Gruben and McLeod, 1998). In an increasingly open economy such as Brazil, the investment is financed by private and public savings, with increasing participation of foreign savings. In this paper, we used international accounting conventions, whose basic functions are formally described in detail by Ramos and Feijó 2004).

It is useful to present the basic macroeconomic identity, given by the equality of product produced (Y) and the product sold (household consumption – C; investment spending – I; government expenditure – G; and balance of exports and imports - (X - M)). It follows: $Y = C + I + G + (X – M)$ or $Y = C – M + I + G + X$, or $(X – M) = Y – (C + I + G)$ (a). Part of the income is spent on tax (T) and government transfer (TR), which provides disposable income, Yd = Y + (TR

– T) (b). This part of income is allocated to consumption (C) and Savings (S), where: Yd = C + S (c). From (b) and (c) it is obtained: C + S = Yd = Y + (TR – T) or C = Yd – S = Y + (TR – T) – S (d). With a simple algebraic treatment of the identity (d), we have: S – I = (G + TR - T) + (X – M) (d'). Manipulating equation (d), it is possible to highlight the government's budget: T – (TR – G) = (I – S) + (X – M). Therefore, there is a close relationship between domestic, public and foreign savings.

However, in theory, public savings (TR – G) and taxes (T) are considered rigid due to institutional constraints and C is a function of the very product (C = f (Yd)). So, domestic savings is more directly related to foreign savings: S – I = g (X – M) (e). Strictly speaking, in order to test these hypotheses further econometric research should be conducted in order to validate the effective relationship between these aggregates and check possible spurious correlations.

This relationship is under dispute in the Brazilian economic literature: (1) the Endogenous ***Growth Approach – EGA*** (associated to Latin America import substitution doctrine) sustains that positive trade balances give rise first to greater investment and later to savings. To promote investment interest rate should be low and exchange rate should be devaluated. Therefore, the capital flows and exchange rate should be controlled. In other words, trade balance depends on aggressive economic policy; (2) the ***Open Growth Approach – OPA*** (associated to the Asian approach, but also Germany) states that savings (domestic and foreign) brings positive trade balances, great savings and them a promotion to investment. The condition to development is to have a savings greater than investment and ideally positive trade balance. Today the consensus on how to deal with exchange rate is to leave it to float.

The first strand (EGA) aligns with the results obtained by Bresser-Pereira (2009) and Rodrick (2007). According to this perception, it would be a high percentage of "neutralization" of foreign savings for domestic savings. Such evidence confines the empirical results obtained by Fry (1978), Feldstein and Hirota (1980) and Rocha (2004). Edwards (1995), in turn, in a comprehensive study concludes that there is a clear "substitution" (and not "neutralization") between private domestic savings and foreign savings. However, the variances are very large. Estimates of substitution vary from 0.38% to 0.62%, depending on the country considered. With

these studies, there is not much doubt that there is effectively a substitution effect, but with some difficulty establishing a stable structural pattern.

In Brazil, between 1994 and 1999 (period in which fixed exchange rate regime), there was substantial increase (4.3%) in the Current Account deficit (X - M < 0) which was covered mainly by FDI (much of that coming from privatization). At the same time, there was a decrease in the investment rate from 21% to 19%. After the devaluation of the real in 1999, there was a change in Current Account, gradually becoming positive (X – M > 0). Paradoxically, this period shows the rate of aggregate investment decreasing. It fell further, reaching 16.5%. Why did it happen? From this perspective, in early 2000, there was a process of substitution of domestic savings (resulting from exchange rate depreciation) by foreign savings (the result of inflow of foreign exchange arising from trade and foreign capital). Before and after 1999, there was an appreciation of the exchange. First because of a unreal and fixed exchange rate and then a result of the flow of foreign exchange from exports resulting from growth in demand for commodities. In both periods, inward FDI was positive. Only after 1999, outward FDI became a macroeconomic phenomenon.

This view assumes that economic growth with foreign savings appreciates the exchange rate by limiting investments to the export activity. This hampers the growth of medium and long terms and does not cause the growth of savings. The exchange rate appreciation (and import of goods) would have only a stimulus to increase real wages and the temporary control of prices. This is associated with the effect of spending on household consumption, with little multiplier effect. In this line, Dooley *et al.* (2003) criticize the policies of exchange rate fluctuation and the liberalization of capital flows, suggesting the maintenance of local currency depreciation. This would be accompanied by the achievement of current account surplus, making the country an exporter of capital and accelerating economic growth. China and the Asian tigers operate precisely under these conditions: depreciated exchange rate, current account surplus, capital export and inward FDI.

OPA's view is supported by Pastore et al. (2008) and Paiva (2006), within the more traditional neoclassical school. In addition to finding that the depreciated exchange rate has a

negative effect on consumption and inflation (net of the volatility in nominal terms, which ultimately affects the real exchange endogenously), the critical variable to be investigated is the savings rate. The formulation of Solow (1956) spread the theory of economic development that savings plays a central role in leveraging growth: countries that save more in per capita terms are those who acquire higher growth rates and has a more depreciated exchange rate and current account surplus higher.

With the firm conviction that this issue is still to be further investigated, this study tends argue that
OPA's perspective is more solid. Indeed, exchange rate (real) undervalued is the direct result of excess savings over investment. The continued growth of reserves weakens the exchange rate policy. In the Brazilian case, the balance in current accounts (due to the increase of X - M) and Capital Account (due to increased FDI) contributes to the accumulation of foreign exchange. This is equivalent to the excess of savings over investment (S - I = X - M). It occurs because of the change in relative prices of assets and goods and services, inside and outside, which makes the dynamic movement of FDI, both within and outside the country. Particularly FDI is due to a fall in the relative price of foreign assets and increase business competitiveness (the result of this process of capitalization and increase the volume of investment in machinery and equipment).

Accounts with negative results mean that there was more output than input of resources in that rubric. According to the official IPEADATA (2011) the main accounts with negative outcomes are royalties, interest, rents and services. The positive accounts are direct investment, portfolio investment and trade balance. The result of Balance of Payments – BOP positive (negative) means an increase (decrease) in reserves. Increase (decrease) may mean a pressure on the exchange rate, reserves and the relative prices. From an accounting perspective, these reserves allow the identity of Current Transactions and Capital and Financial Account (CT=CF). Indeed, there is a basic difference between the two accounts. CT, dominated by the dynamics of foreign trade, does not create a future liability because the transaction is closed when a sale of goods or services (or payments) is performed. CF is dominated by the flow of capital between nations. If an asset is bought with foreign capital, a liability is raised because the interest plus the principal

must be paid at some point. The exchange rate obviously affects the relative price of all flows in the BOP and also the terms of trade between nations.

One way to understand the implications of the dynamics of these flows is through the relationship between capital flows and balance of payments, which incorporates business transactions of a nation with the world. The cases presented in figure 1 and discussed in Table 3 show the difficulty in treating the doctrines of growth only by the pair of growth "out" or "in". Depending on the framework of a nation in one of case studies, policy recommendations related to FDI can be done. In fact, Brazil is covered by the case 3 having a combination of surpluses in terms of capital flows and trade balance, influencing a good performance on BOP accounts. Given the conditions of a growing reserves and pressures on the valuation of the local currency, encouraging capital outflows through (OFDI) can be recommended, ensuring lower volatility and higher return on reserves. Nonetheless, these policies, such as the creation of a Sovereign Wealth Fund - SWF, should be driven in a long term perspective given the extreme fragility of the international monetary flows after 2008.

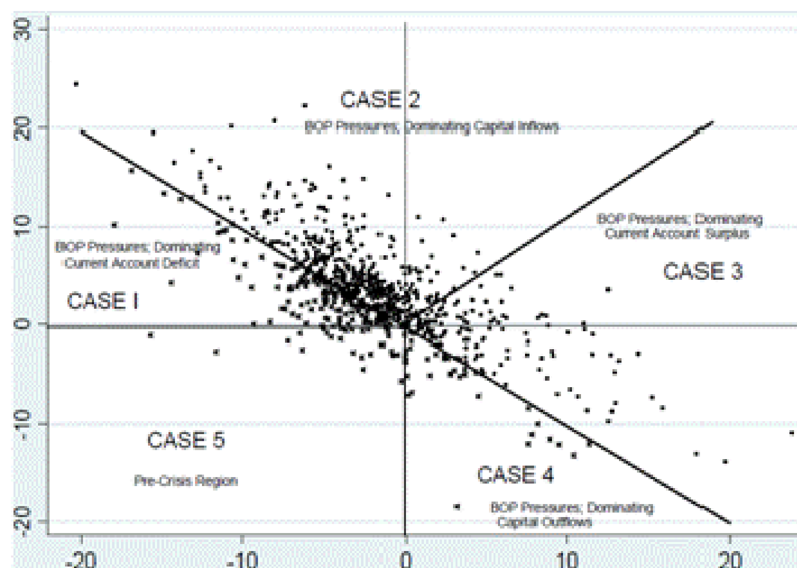


Figure 1: Total Capital Flow (vertical axis) and the Current Account Balance (horizontal axis), as % of GDP, 1989-2007, including 50 countries.

Source: [17].

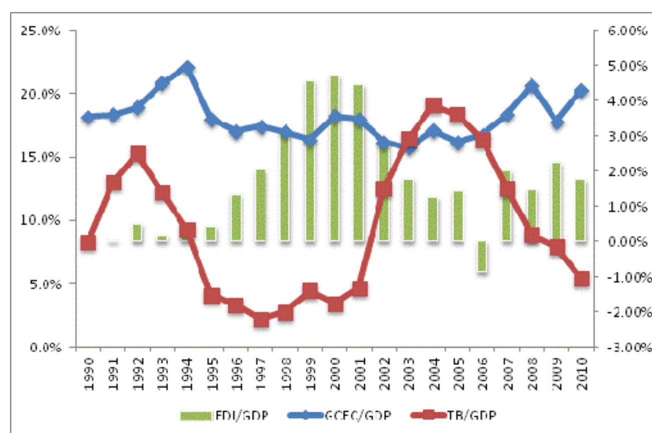
Case 1 (positive net flow of capital financial the current account deficit): The premise here is that capital flows are responding effectively to the demand for foreign savings. However, although the sum of capital flows on the current account balance is positive, the heavy dependence on capital flows makes these situations a calculated risk by the weight of the negative current account.
Case 2 (flows of capital in search of income): This is the case with the largest number of observations or situations. Instead of responding to demands for financing the current account, clearly this situation the high liquidity of capital migrates in search of income, with opportunistic characteristics, where there is a deficit (most cases) or current account surplus. Observe that this is the situation where capital flows are dominant, which can pose risks in times of shortage of international liquidity.
Case 3 (pressures by current account surplus): In this case the volume of comments is not as significant as in previous ones, indicating an area of current account surplus and, in some cases, a positive sum of capital inflows. If the current account balance is positive but not excessive, then policies to encourage capital outflows are recommended.
Case 4 (capital flight than the current account balance): In this case there is clearly a matter of negative pressure on the capital and financial account of BOP and a likely weakening of growth in the long term.
Case 5 (pre-crisis BOP) There are bad indicators of capital outflows and also the current account deficit, which makes the debt the only way, apart from insolvency.

Table 3: Relationship between capital flows and balance of payments in specific cases, following IMF
Source: Compiled from Ghosh et al. (2008)

Evidence of movements in the accounts of the BOP, particularly the relationship between FDI, Trade Balance, Gross Fixed Capital Formation (GFCF) and imports to GDP is shown in graphs below. Brazilian economic integration abroad started particularly from 1994 onwards. Current account surpluses reduce external debts and de-dollarisation of its liabilities, both public and private, which allows a greater monetary stability. The relationship between a positive view of foreign savings in the BOP (positive relationship between exports and imports) and domestic savings are inversely proportional. Clearly there is an inverse relationship between investment / GDP and net exports (current account surplus) / GDP. This shows that there is not a full replacement of external and internal savings, but only partial. Pastore et al. (2008) and his colleagues note that the current account deficits are associated with higher rates of investment.

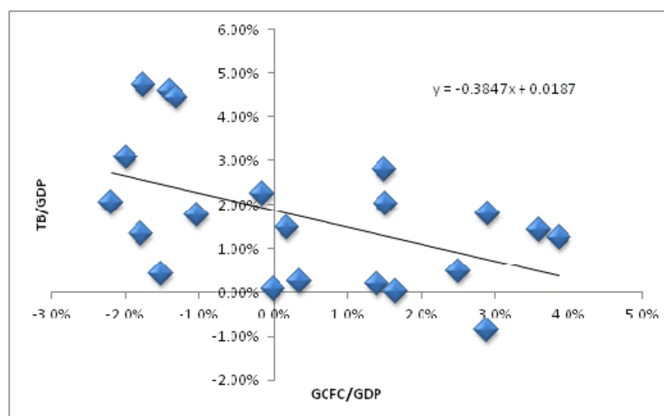
Likewise, the authors of this study calculated the ratio of the sum of current account balance with the balance of FDI as a ratio of GDP and the ratio of investment to GDP, obtained inverse correlation between the two variables. Using IPEADATA and following Campos and Kinoshita (2003), it is possible to correlate these variables and conclude some dynamics on how foreign savings are important to investment.

Graph 1 shows, from 1990 to 2010, the dynamics between Trade Balance (TB), Foreing Direct Investment (FDI) e Gross Fixed Capital Formation (GCFC), in its relation to GDP. From 1994 to 1999, due to the artificial appreciation of the local currency, trade balance was negative, but FDI positive. Foreign savings was partially compensated by foreign capital. In this period the investment rate slowed down. From 2000 onwards, with the floating exchange rate, there is a reversion on these tendencies.



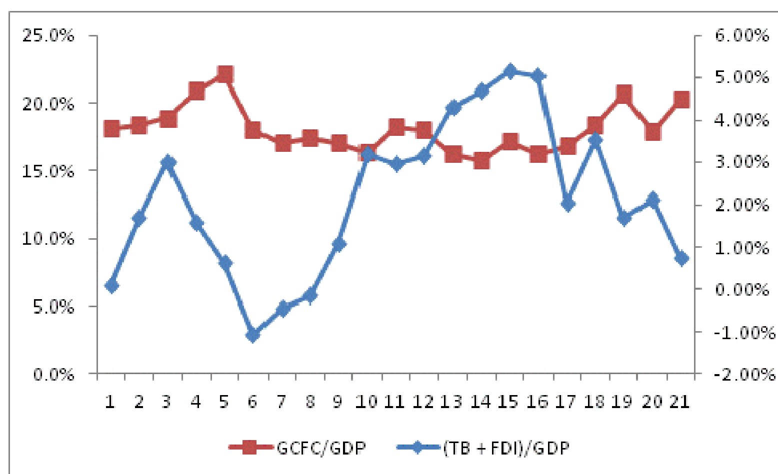
Graph 1: GCFC/GDP (Left), TB/GDP e FDI/GDP (right)
Source: IPEADATA.

The relation of foreign savings and GCFC to GDP is clearer in the Graph 2. For the whole period, the dorp in the Foreign Trade (X – M) is compensated by the increase in FDI. It is importante to point out that the correlation between TB/GCP and FDI/GDP is approximately 50%.



Graph 2: TB/GDP (vertical) e GCFC/GDP (horizontal).
Source: IPEADATA.

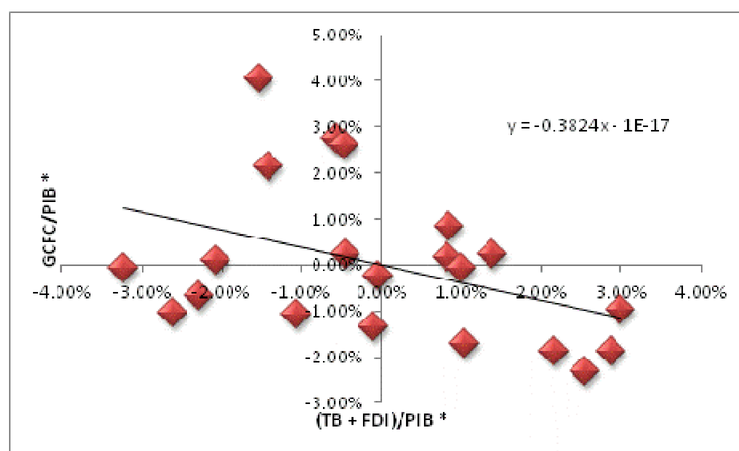
Graph 3 presents the relation of the rate of captial formation and the total TB and FDI, both as percentages to GDP. The adjustment of the curves is similar to the Figure 1. It means that, on average, the drop on TB is compensated by FDI and vice-versa.



Graph 4: (TB + FDI)/GDP (left) e GCFC/GDP (right).
Source: IPEADATA.

Finally, Graph 4 presents the data dispersion over the average value of the variables. The data show clearly that there is a strong correlation between foreign savings, FDI and the rate of investment as a percentage to GDP. Moreover, if TB + FDI is lower than average, the endogenous variation of GCFC is more expressive. It demonstrates the importance of the relation

between foreign savings (TB and FDI liquid) in the formation of the investments in relation to GDP.



Graph 4: (TB + FDI)/GDP* (horizontal) e GCFC/GDP (vertical).
Source: IPEADATA.

The addition of the curve of investment (GFCF) and FDI implies a curve even more adherent to the theory that there is no perfect substitution between domestic and foreign savings, and that the deficits were much associated with the movement of investments. Given the institutional rigidities in public savings, derived from the fragility of fiscal policies to monitor the dynamics of current accounts, the eventual replacement of foreign savings for the public is not easily verifiable, leaving a stronger relationship between foreign and domestic private savings. Thus, the growth in current accounts will be absorbed by a contraction of investment, as we predict theoretically by Obstfeld and Rogoff (1996). But, there is another interesting relationship between foreign savings, together with the balance of FDI and investment performance. The latter brings a strong correlation with imports, as shown by the data from Figure 4, a fact highlighted by Pastore *et al*. (2008) Also worth mentioning is the fact that imports depend heavily on investment and FDI abroad. Moreover, it is easy to verify that there is no significant correlation between these variables and domestic consumption, which classically depends on national income (GDP). Therefore, the hypothesis of Bresser-Pereira (2009) that the currency appreciation is detrimental to growth because this value could be reversed primarily for

consumption is flawed. In fact, this can happen, but the inertia of consumption is higher, compared to income growth than to changes in a single aggregate national accounts, in case the trade balance. It should be noted that the BOP situation in Brazil is very positive since 2001, with two crucial limiting factors: increasing exports, particularly of commodities, and large FDI inflows, which caused an increase in international reserves. It follows a fall of the "country risk". However, as claimed by Rodrick (2007), this wealth coming from abroad can suffer strong shocks. In fact, after the 2008 economic crisis, international trade grows less, with lower availability of external financing and increased propensity of the U.S. and rich countries reduce their trade deficits and their household consumption, which can cause a drop in international trade and FDI inflow, reducing the situation that still prevails in the country. The question now is whether the conditions for the country to maintain economic growth with greater openness and with the increase of FDI in Brazil, with a view to creating national global players able to compete and increase long-term productivity of the economy.[i]

3. Method

What are the context and the feasibility of adopting policies to strengthen the Brazilian outward foreign direct investment – OFDI? First, we developed the theoretical survey as a means to better understand the phases and the characteristics for the adoption of policies to enhance FDI. Besides, we collected empirical evidence of the growing importance of foreign accounts to the Brazilian growth. Simultaneously, the revision was done on models seeking to account for FDI, especially the approaches developed by Dunning. More recently, there are collections of works organized by Sauvant (2009) and Sauvant et al. (2008) advancing the policy issue, addressing the institutional rules, support for public policies explicit and implicit and the source and destination of investment. The review of this literature includes the prism of internationalization of companies, particularly emergent countries. It becomes clear that the relevant phenomena of inward and outward FDI and its growing weight over the international trade of goods is not accompanied by policies of emergent economies. Brazil is no exception. The

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process of internationalization in Latin American is due to privatization reforms and economic liberalization that followed the exhaustion of the process of industrialization through import substitution. However, there is no policy to support the new transnational corporation in these countries.

In Brazil, the significant size of the domestic market, the favorable conditions to augment reserves and the incremental process of economic, financial and commercial openness turned FDI a prominent issue since the Plano Real, in 1994. This supports the view that the firms and the state should be prepared to enforce strategies to overcome the competitive and somehow regulated global economy. In contrast to other countries, as suggested in Table 4, Brazil still is in debt in terms of constructing a strategy and the consequent public policies to guide the private sector.

Characteristic	Most relevant Implications
Industrialization and production with focus on foreign market	▪ nascent industry develops in the midst of searching for strong external orientation ▪ contact with foreign markets and early exposure to international standards of competition in product and process
Great participation of public funds for financing	▪ transfer through subsidized interest rates, long grace periods and amortization periods outstanding performance of the funds Eximbanks ▪ resources generated in certain economic activities carried out by large
Stimulus to the formation of large economic groups	▪ presence of large conglomerates ▪ trend and encourage the concentration ▪ vertical and horizontal integration ▪ creation of inter-sectoral linkages, measures aimed at creating market reserve ▪ conglomerates producing gains reinforce vertical integration scale
Integration between patterns of trade and investment	▪ promoting development with explicit attention to the role and level of integration with financial system development model
Incentives to supply of technology	▪ oriented policies tended or productivity gains linked to incentive policies, ▪ import of designs and plans, gains through the process of technology transfer and learning

	▪ opening for the development of national innovation system - in contrast to the National Science and Technology
Behavioral Aspects	▪ support and investment in vocational training in technical and engineering ▪ clear vision and commitment to the business development model ▪ strengthened political and cultural aspects-oriented model by integrating inter-and intra-sectoral

Table 4: Main features of state strategies for internationalization in selected countries: South Korea, China and Japan.
Source: Authors.

Considering the international benchmarking and the set of explanatory contributions on FDI to economic development, the research follows three levels of suggested analysis: macroeconomic, microeconomic and foreign relations. Methodologically, this view maintains that the research activity should be initiated by the theory. In this case, following Dunning, these three topics are in the core of the theoretical domain in the field. The advantage of this procedure is related to the concept that theory: (i) summarizes and explains the facts and their relation; (ii) permits the classification and systematization; (iii) guide the gaps in knowledge; (iv) summarizes and explains what science knows about the issue; and (v) provides the construction of hypotheses for investigation.

From the methodological point of view, the research culminated in three dimensions, shown in Figure 2. The main elements can be summarized as follows:

- **Macroeconomic**: addresses the specific constraints of the dynamics of large aggregates of the Brazilian economy whose dynamics interfere with the formation of the GDP, general price index, pattern of savings (S) and investment (I), FDI and other economic variables;
- **Microeconomic/industrial organization**: relates to aspects of industry organization and market structure (including business strategies of investment) and technological paths;

- **Foreign relations**: endorse factors endowments (capital, property rights, etc.), location and other factors related to the forms of action in foreign markets (including the opening of branches and internalization of production).

As explained in the Figure 3, the dimensions (macroeconomic, microeconomic and foreign relation) include positive aspects associated with FDI, but not restricted to them. As proposed here, they allow: the framing of the landscape of political inclusion of incentives for foreign investment (section 4) and also serve as a reference to public policy agenda proposed (section 5).

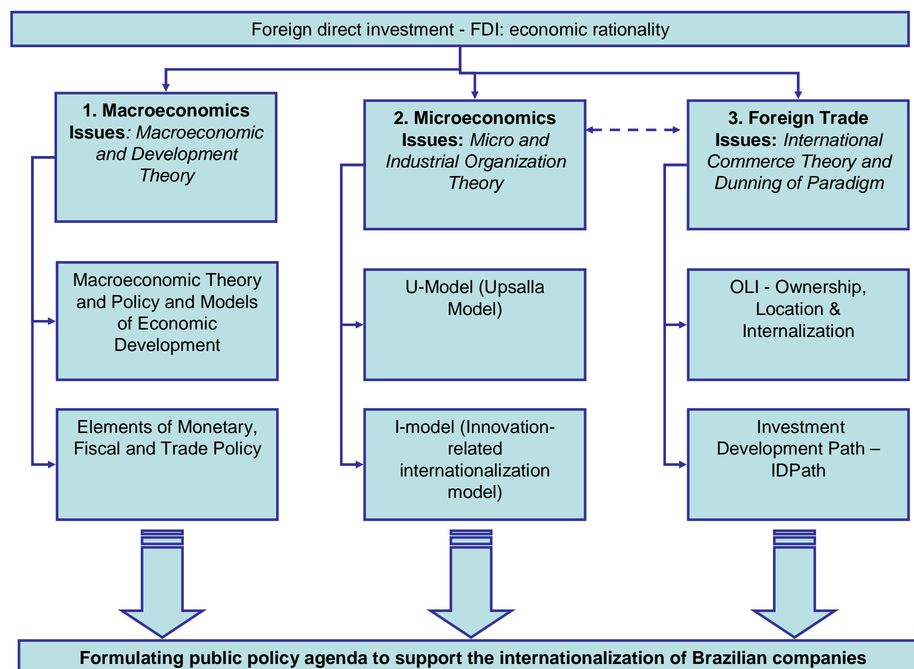

Figure 3: Summary of the methodological framework adopted
Source: Authors.

4. Comprehensive FDI policy perspective

Table 5 presents an overview of integration of policies to encourage outward Foreign Direct Investment – OFDI. It focuses on the analytical dimensions outlined in the previous section. The field of macroeconomic policy covers issues related monetary, tax, and financial instruments. It should be drawn attention to the Sovereign Wealth Funds – SWF, a new mechanism to finance long terms investments to shape national strategies. Altogether these policies can be used for promoting macroeconomic stability and strengthening national sectors where the country has competitive advantages. The field of foreign relations policy emphasizes the role of Eximbanks, mostly used by Asian economies.

Trade and globalization go together. Moreover, the strengthening of local businesses regarding foreign companies can also be achieved through mergers and acquisitions. Finally, the field of microeconomic policy is focused on a set of aspects (economic defense, regulation of mergers and acquisitions, incentives for innovation and metrology). The internationalization has much to gain from the strengthening of the industrial park through improved quality of regulation and provision of technological services.

MACROECONOMIC POLICY		
Monetary and exchange rate	**Tax policy / tax**	**Brazil SWF- BSWF**
• Surplus in trade balance surplus in the capital and financial account of BOP; deficits in nominal tax bill: the real situation is assessed, with negative consequences for exports. • Fiscal account deficit increases the interest and bring more volatile capital which leads to more appreciation of the exchange.	• Fiscal loosening (increased costs) affects current account surplus, reducing the pressure on the balance of payments. It need to be simulated in terms of other effects such as its impacto n competitivity. • This policy can surely bring an increase in interest rates, which encourage the arrival of short-term capital,	• New private financial players have entered the scene of FDI: private equity funds – PEF and venture capital funds - VCF (these more present in segments based on emerging science and technology), led by market signals; • Sovereign Wealth Funds – SWF. led by the government with the concept

• Floating exchange rate policy, reserves tend to reduce their rate of accumulation, with the relative enhancement of national assets and reduced exports.	increasing the pressure on exchange rates. • The two movements (pressure on fiscal policy and monetary policy) will require actions such as raising interest rates which reduces the dynamism and growth of output and income	of constructing long term strategies for development in strategic projects, not necessarily following market signals. In Brazil, the discussion of rules and policy of the National Sovereign Fund is controversial. • The use of instruments such as restrictions on foreign investment on specific segments and the legal risks and uncertainties is still incipient.
FOREIGN TRADE POLICY		
Action of Eximbanks	**Development Bank / Eximbank**	**Integration Eximbank / DB**
• There are certain limitations in the policy of support to exporters: tools for this market are operated by various ministries. • In 2009 the government announced the creation of the Eximbank, which will be linked to BNDES. • Its operations are centered - which should contribute to better organization of foreign trade • New bank should not finance investments in other countries, only lend to governments or foreign companies that want to buy Brazilian products	• Promote debate on issues such as: • (i) With the increase in international liquidity and capital flows, the extent to which BNDES reconcile their lines of work? • (ii) BNDES has a clear agenda on this issue, linking it to well-defined policies and investment • The posture of the BNDES is still dubious, including mergers and acquisitions - M & A. There is no formal position on the process of integration between the stimulus to exports and strengthening domestic enterprises in foreign investment and trade.	• International trade, FDI and the concentration of economic activities are Siamese twins in that part of the modern pattern of accumulation of capital internationally. • Countries that opened their economies perform better, attract more capital and showed significant increases in trade. In short, trade performance and investment inflows go together.
INDUSTRIAL POLICY		

Economic Defense	Mergers / Acquisitions (M&A)	Innovatin/TIB
• Country has the Brazilian System for Protection of Competition - SBDC, which consists of a set of government agencies responsible for promoting a competitive economy in Brazil, through prevention and enforcement actions that may limit or hinder free competition. • There is room for shares to elect winners as a means to strengthen productive segments with an international vocation.	• Liquidity conditions in world trade greatly reinforced access to long-term debt and practice of M&A , which is closely linked to the practices of internationalization of capital. • M & A is often used to expand inward and outward FDI and there is no formal strategy to even direct the Brazilian efforts in the area, other than helping national champions.	• The production system operates in a context of growing need and dispersed based laboratory accredited to provide testing and calibration studies in the field of compliance. There is no metrology policy to direct the Brazilian efforts in foreign • Many companies have no culture of use of technological services from initial design proposals / projects which causes loss of value in these activities. Policies should guide the private sector in this issue.

Table 5: Overview of OFDI incentives
Source: Authors.

5. Proposals for an agenda of priority to Brazilian FDI

Moran (2008) argues that there are three strategies for FDI policies: promotion, inhibition, and neutrality. Such alternatives are motivated by two major issues: (i) Does FDI bring out some damage to the origin country, affecting the labor market, taxes and draining resources to another country?; (ii) Does this type of investment imply some loss of control by governments on national autonomy and related resources? The proposals, presented below, argue that there is economic rationality to businesses, government and markets in more active government action towards FDI, particularly outward flows. As defined, public policy actions are defined in three levels: macroeconomic, microeconomic and foreign relations and trade.

5.1 Macroeconomic

The monetary stabilization and the economic foreign integration (which actually justifies the existence of a strong flow of capital into and out of the country) started with a first wave of tariff reductions (in early 1990s) and the monetary reform of 1994 (known as Plano Real). The Plano Real would not be successful without actions taken on privatization of public enterprises (particularly steel, electric and telecommunications), new fiscal approach to control state expenses and to improve tax revenues and, finally, the application of a quite strict orthodox monetary policy. In fact, interest rate was used to adjust the rhythm of economic growth and inflation. Exchange rate, first kept artificially appreciated (1994-1999) was then substituted by the regime of inflation target with free exchange rate flotation (1999-today). In both cases the appreciation of the local currency is the rule. These measures have kept the memory of inflation stemmed. The cost was a relatively slow growth, dependent on foreign savings, as recognized by most analysts in Brazil [2, 18].

Since 2000, Brazil has a situation of trade surplus. BOP has a positive balance in the capital and financial account, but still has a nominal deficit in the fiscal account. This has contributed to appreciate the real, which has negative consequences for the export of manufactured goods. This effect can also affect the export of primary goods more competitive. The fiscal account deficit is accompanied by high interest rates. This reinforces the movement of exchange rate appreciation. With the policy of floating exchange rate, reserves tend to reduce their rate of accumulation, with the relative enhancement of national assets and reduced exports.

The other perspective is that of China: it keeps the exchange rate artificially depreciated. This makes domestic assets remain undervalued to attract FDI. Furthermore, by expanding its exports by increasing the reserves, SWFs is used as an instrument of policy investment for national strategic projects, including some OFDI. In a situation like Brazil, it is important to indicate that both the World Bank and the International Monetary Fund [17] suggest that monetary policy as the "relaxation" of restrictions on OFDI since it relieve pressure on the exchange rate. This is very bold and interesting, because the country could have a policy of strengthening its presence in industries outside the country, with higher yields than the remuneration of reserves (which earn interest below 1% bringing in significant loss in the medium and long time, given the inflation in

dollars). It should be considered, however, that SWF projects are governmental and not necessarily market driven, carring a greater risk that must be considered in the policy formulation. This strategy may enhance the formation of leading global companies, able to increase the Brazilian presence outside.

Monetary and exchange rate	Fiscal Policy / Tax	BSWF in the context of FDI
• World Bank and International Monetary Fund suggest policies of "relaxation" of restrictions on OFDI (investment abroad), which would relieve pressure on the exchange rate in countries with BOP surplus. Special interest rates and tax incentives should be considered. • Policy of strengthening its presence in industries outside of the country justified by the higher yields than the remuneration of reserves (which earn interest equal to the basic American U.S. Treasuries) gains with the formation of leading global companies, using this instrument to regulate exchange rate volatility. • Uncertainty and/or high risks should be considered in the formulation of this strategy.	• The tax issue facing FDI does not necessarily harm the national accounts. • Election of policies aimed at strengthening the Brazilian FDI requires a paradigm shift, and the most recommended neutral model (Capital Export Neutrality). • System has been very little used for economic policy at the expense of allocative character of a logic based on the volume of the collection and combating tax avoidance	• Creation of a systematic discussion and technically competent in the area of economics and law to discern the role that the FSB would have as an instrument of monetary and exchange rate stabilization. • Instrument would promote activities for FDI in Brazil, and other strategic purposes (such as the promotion of developments of infrastructure and sustainability projects, promotion of sectors where the country has a vocation such as paper and pulp, steel, oil and gas Biotechnology, animal protein) . • The selection of sectors to be promoted is always a debatable question. Market signals should always be considered the portfolio analysis.

Table 6: Public policies and macroeconomic guidance to foreign investment in Brazil - OFDI.
Source: Authors.

The tools to do so could be the strengthening of conditions for exports, via the creation of an Eximbank and the effective implementation of Brazil's Sovereign Wealth Fund – BSWF. In addition to measures in the tax policy (including changes in taxation of funds in the portfolio), the alternative is to increase the interest rate as a means to sterilize the inflation caused by the inflow of dollars. With some inflationary pressure, the action at hand is to maintain the exchange rate appreciated moderately, responsible fiscal policy and the encouragement of Brazilian OFDI. As suggested above and in Table 6, the encouragement of FDI is justified as auxiliary instrument of economic policy.

5.2 Foreign relations and trade

The exchange is strongly influenced by the flow of goods and financial transactions, especially FDI. There is a strong relationship between capital flows and current account, the result of greater or lesser use of foreign savings. There are times when capital flows meet the demand for financing of current account deficits and other moments that are more speculative and depend on opportunities for short-term income. After the crisis of the 1980s (marked by enormous pressure over its BOP), Brazil has gradually entered into a comfort zone in the medium term, particularly when there are positive signs for both the incoming flow of capital. After the 2008 crisis, due to reversal of commodity price and exchange rate appreciation of 2009, the Current Account impacts was strongly felt. Moreover, statistics indicate that there is strong correlation between trade and investment. Stimulating international trade generates numerous benefits. Specifically, the contact with external markets exposes companies to international standards of quality, price and other requirements of foreign markets. The interaction of businesses with foreign markets leads to increased resource productivity and generates spillovers, ensuring greater efficiency in production, foreign exchange from exports and technology transfer (FROUFE, 2009). Finally, trade also generates a gain to expand the operational scale, making companies less dependent on the domestic market and the economy less susceptible to external shocks. A summary of these factors are presented in Table 7.

Action of Eximbanks	Export financing and the role of Development Banks	Eximbank financing and integration
• The Eximbanks can and should co-finance actions in the database (in the case of BNDES) providing funding for short-term and medium term associated with production and commercial operations, through financing the buyer, export of capital goods and project finance oriented growth of business activities abroad. • The feasibility of fund investments in other countries is debatable. The control over technology and other assets should be considered. The balance between OFDI and export is a question yet to be defined in Brazilian policy.	• Agencies and development banks in some countries are ahead in seeking to integrate these "new" spheres of activity of enterprises abroad explicitly - as in the cases of Japan, South Korea and India P. ex. • A breakthrough in terms of action should be oriented towards: • (i) promote the natural synergy between the business plan and actions to stimulate investment (ii) expand the scale of cooperation with foreign markets and the influx of capital among trading partners.	• Countries that opened their economies perform better, attract more capital and showed significant increases in trade. • International trade, FDI and the concentration of economic activities are Siamese twins in that part of the modern pattern of accumulation of capital internationally. • In short, trade performance and investment inflows go together and are reinforcing, producing gains collectivity.

Table 7: A Reference to Public Policies towards Brazilian OFDI.
Source: Authors.

5.3 *Microeconomic*

In Brazil, the literature on public policy in the field of international direct investment and its relation to industrial organization is scarce. Mostly they are devoted to advanced capitalist economies as it can be appreciated by the publications of the Vale Columbia Center on Sustainable International Investment (http://www.vcc.columbia.edu/content/publications), perhaps the most important study center on the topic, now a day. Also, a series of recent Brazilian publications are investigating the theme under the various perspectives (Fleury (org.), 2010; and Barros & Giambiagi (org.), 2008). Moreover, there is no consensus on how to regulate

FDI. The objective is to attain more efficient allocation of resources, particularly if it considers the balance between the private and the state interests involved and the macroeconomic restrictions to investment. This literature is grounded on factors such as "location incentives", "performance demands" and "induced barriers", to protect de local producers (ECIB, 1993). More recently, there has been a policy to demand performance in terms of the scale required to Brazilian firms to compete abroad. Perhaps this is the sole policy we can detect in the area of FDI (Ramsay & Almeida (org.), 2009). In fact, although the literature deals with topics such as technology, generation of spillovers, export promotion and generation of new investments, the policies are still quite restricted to actions of the Banco Nacional de Desenvolvimento Econômico e Social - BNDES. A review of these studies and the literature indicates that there is a huge challenge to consolidate the process of internationalization of the Brazilian economy (PIB, 2010). This includes the dissemination and access to technology services in addition to export promotion and strengthening of companies and industries with an international vocation. Table 8 summarizes some of the policies, considering that it is still a mere reference to future studies.

Economic Barries	Regulation of mergers and acquisitions	Innovation and Technology Industrial Base – TIB
• Ensuring the protection of competition and the formation of cartels; • Promote companies to obtain economies of scale to ensure a high level of competitiveness and productivity. • Temporary barriers to protect emergent innovation firms and segments or even natural resources. • Promote national champions to guarantee competition in large-scale operations in local oligopolistic markets and foreign markets with	• Complex M & A constitutes the most common form of expansion of FDI, so it must be contemplated in the industrial policy. • Promote the formation of strategic alliances. • Creation of R&D consortia, technology licensing agreements, subcontracting arrangements with involvement of less tangible resources. • Public debate on FDI impact on selective sectors, particularly in health, environment and energy. .	• Large space to organize and grow the system of metrology, particularly when the internationalization demands standards and certification of conformity of products and services by accredited sources. • Search of mutual recognition of certification systems and national accreditation, increasing the product in each compliance test required. • Use horizontal policies that promote more intensive use of

Brazilian comparative advantage. • Reduce dependence on outside contractors of strategic inputs, such as technologies useful to the power system, health and environment. • Promote the search for strategic assets through OFDI.	• SWF should be included in the Brazilian agenda as fast as the foreign reserves increases.	technological services for businesses, such as specialized integrated firms in complex systems such as air space and nuclear industries.

Table 8: FDI policies to microeconomic level
Source: Authors.

6. Final remarks

This research contemplates a review of the literature on the internationalization of capital through multinational corporations, with emphasis on economic theory. Three dominant theoretical perspectives were explored: the OLI paradigm and models of U and I, developed from the work of John Dunning. These schools focus on critical dimensions of the relationship between FDI and economic growth. The Brazilian academy and the public sector have still a long way to debate this important issue. In this article, it is concluded that the investment of multinational companies brings competitive advantages in not only organizations but also international trade and economic growth through increased foreign savings. With these dimensions in perspective, it is summarized a public policy agenda for OFDI (Table 9).

Strategic Objectives	Priority Instruments
Macroeconomic a) Monetary and Exchange Rate Stability b) Modernization of Tax Legislation c) Establishment of the Brazil's SWF	• Trigger capital flows as an instrument of economic growth. • Promote capital flows and foreign trade to boost national saving. • Establish the SWF and FDI as additional instruments of monetary and exchange rate stabilization. • Rationalize fiscal incentives and taxation to export and to invest abroad. • Avoid double taxation and facilitate the use of credits, particularly for export (Eximbank).
Foreign Relations and Trade a) Promoting openness to foreign trade and FDI flows b) articulated regulatory framework to promote development and investment to trade and FDI	• Articulate official policies of the funding system to domestic and foreign FDI through BNDES. • Strengthen the public financing system (BNDES, BB, CEF) and private in order to increase the productive capacity of local enterprises in specific sectors. • Creation of the Eximbank of Brazil, incorporating not only financing, but operating throughout the value chain in the export and import, including FDI. • Through the resources of funding and financing, promote the formation of alliances, R & D consortia, technology licensing contracts, sub-contracting, involving tangible and intangible resources for FDI.
Innovation a) Strengthen the system of technical barriers b) Regulate mergers and acquisitions c) Support to Innovation	• Incorporate the role of FDI in the innovation agenda to facilitate the positioning of leading Brazilian companies. • Innovation policy, technology services (metrology, mainly), infrastructure and R & D & I tied to a stimulus to the national FDI. • Create system of technical barriers in line with accepted international practice. • Map and promote M&A according to market and official state interests.

Table 9: Summary of Agenda for Public Policy Priorities OFDI.
Source: Authors.

The investment of domestic companies abroad brings about earnings to the country of origin of the capital. This position dispels the myth that, be it inward or outward, the flow of capital would be harmful to national interests. Obviously, this theme also brings controversy, but the empirical evidence is very strong in favor of greater openness to capital, either on

macroeconomic and on microeconomic grounds. By recognizing the existence of a very wide range of general and specific policies, we chose to select those that most contribute to the internationalization process and its earnings.

In the foreground, highlight goes to the macroeconomic framework for FDI. The article opens a theoretical and practical possibility of increasing the FDI as a tool to Brazilian exchange control and strengthening of external trade, particularly OFDI. In the same way, the creation of the Brazil's SWF, besides providing greater monetary and exchange rate stability, may promote strategic projects of various kinds. The risks and uncertainties should be critically analyzed in further research. By recognizing the close relationship between FDI and foreign trade, proposals are made to strengthen the Brazilian trade openness. In this field, there is still too much to analyze study and implement. Finally, based on foreign experience, considerations were made on policies for foreign companies operating in Brazil with national production chain. These policies should consider that they involve business and state interests to integrate economies, with impact upon FDI. It tends to decrease trade and transactions costs and easies exports. Moreover, market sizes tend to be greater in relation to fixed investments, making national champions economically feasible.

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