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BRICS: a Comparative Analysis of the Investment Climate

Abstract: Analysis and comparison of the main components of the investment climate in BRICS countries can improve the understanding of factors, which form an attractive environment for foreign direct investment (FDI). The article uses the author's model of the investment climate, consisting of ten components, and research data of international organizations.

Key words: investment climate, BRICS, FDI inflow, competitive advantages, problematic areas of doing business.

The investment climate has a significant impact on foreign direct investment (FDI) in host countries. For its evaluation, the author applies the index consisting of ten components. Improving each of these components significantly contributes to the attractiveness of investing:

1. *The growing size of the market* reduces the cost due to economies of scale, allows for a more flexible strategy due to the greater segmentation of the market.
2. *The increased openness of the economy* expands the number of sectors and industries open to FDI, reduces the ceiling on foreign participation in equity.
3. *Infrastructure development* – allows to reduce production costs and to increase production capacity, connects markets and spheres of economic activities, improves access to facilities and buildings.
4. *Improving the quality of labor* allows to implement technologically complex projects and to improve the quality of the products.
5. Maintaining the relatively low costs of labor creates benefits in price competition.
6. *The strengthening of investment protection* – stimulates the growth of FDI and transfer of technology.
7. *Risk mitigation* – involves the investment of risk-sensitive investors.
8. *The development of financial markets* expands the possibilities for financing projects through the national banking system and stock markets.
9. *Reducing the tax burden* – increases the profit after tax and expands the possibilities of reinvestment and profit distribution depending on the priorities of investors.
10. *Improving the quality of the regulatory environment* – reduces the time and cost of establishing a fully functioning enterprise.

Below are data on the investment climate in the BRICS countries.

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Investment climate

The index of investment climate

In the overall favorability of the investment climate, the BRICS countries are pretty close to each other (see Table 1). Brazil, Russia and India have practically the same index of investment climate. From them only slightly behind is South Africa and a little more – China. However, the positions of countries in the index components are significantly different. First and foremost, you can mark certain ratios, which are separate components.

First, the market size and the openness of the economy are in reverse ratio. I.e., the larger the market size, the more selective the certain country tends to come to open its economy to FDI and, consequently, the smaller is the openness of the economy. So, of the five BRICS countries China has the highest market size and the least openness of its economy. On the contrary, South Africa has the smallest value of the market and greater openness of the economy.

Second, the level of risk affects the degree of investment protection. The higher the risk, the less reliable is investment protection. The greatest risks exist in China and Russia, and these countries have the smallest degree of investment protection. Three other countries – Brazil, India and South Africa – have considerably lower and approximately the same level of risk, and a higher level of investment protection. The variation of the index of investment protection in these three countries indicates that the quality of legal and other protection of FDI can offset some of the risks (as in India, which investment protection indicator is better than indicator of risk). Or, on the contrary, it can create additional vulnerability (as in Brazil, where indicator of investment protection is worse than indicator of risk).

Table 1

The index of investment climate in the BRICS countries, 2016

	Brazil	Russia	India	China	South Africa
Market size	8,29	8,43	9,14	10,00	7,00
Openness of the economy	9,00	8,20	7,40	5,80	9,40
Infrastructure	5,57	6,86	5,29	6,71	5,86
The quality of labor resources	6,46	7,75	5,76	6,70	6,05
The cost of labor	9,44	8,57	10,00	9,31	7,32
Investment protection	6,30	5,10	7,30	4,50	6,80
Risks	7,00	5,20	7,00	5,00	6,90
Financial market development	5,71	5,00	5,86	5,86	7,14

	Brazil	Russia	India	China	South Africa
Tax burden	4,70	6,20	5,14	5,80	5,80
Regulatory environment	5,77	7,09	5,47	6,29	6,49
THE INDEX OF INVESRMENT CLIMATE (WEIGHTED AVERAGE)	7,04	7,04	7,06	6,85	6,96

Source: calculated by the author based on [1],[2],[3],[4],[5].

Thirdly, in the ratio of the level of quality of labor resources and the cost of labor there is generally a direct correlation. For example, India has the lowest quality of labor resources and the lowest costs of labor in the BRICS. Russia has the highest quality workforce and the relatively high level of expenditure on labor costs (which are higher only in South Africa). China and Brazil demonstrate the average quality of the labor force and reasonable costs of labor. South Africa stands somewhat apart. In this country the quality of workforce is only slightly higher than in India, but the salary is the highest in BRICS.

Fourth, in all five countries the indicator of regulatory environment is higher than that of rate of tax burden; the higher the quality and efficiency of the regulatory environment are, the lower tax burden is. Therefore, Russia has the best regulatory environment and the lowest tax burden in BRICS. On the second and third place in the regulatory environment are South Africa and China, these two countries share second-third places on the tax burden.

Ranking

The ranking of the countries under consideration for the individual components of the investment climate is as follows:

Market size. 1st place – China 2nd place – India, 3rd place – Russia, 4th place – Brazil, 5th place – South Africa.

Openness of the economy. 1st place – South Africa, 2nd place – Brazil, 3rd place – Russia, 4th place – India, 5th place – China.

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[1] Global Competiveness Report 2015-2016. /ed. by Klaus Schwab/. Geneva, World Economic Forum, 2015.

[2] Data on the index of regulatory restrictions to FDI // the OECD website - http://www.oecd.org/investment/fdiindex.htm.

[3] The Human Capital Report 2015. World Economic Forum, 2015.

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[5] Data on the index of political risk in the countries of the world // the website of the PRS Group - https://www.prsgroup.com/category/risk-index.

Infrastructure. 1st place – Russia, 2nd place – China, 3rd place – South Africa, 4th place – Brazil, 5th place – India.

Quality of labor resources. 1st place – Russia, 2nd place – China, 3rd place – Brazil, 4th place – South Africa, 5th place – India.

Cost of labor. 1st place – India, 2nd place – Brazil, 3rd place – China, 4th place – Russia, 5th place – South Africa.

Investment protection. 1st place – India, 2nd place – South Africa, 3rd place – Brazil, 4th place – Russia, 5th place – China.

Risks. 1st and 2nd places - Brazil and India, 3rd – South Africa, 4th place – Russia, 5th place – China.

Financial market development. 1st place – South Africa, 2nd and 3rd places are shared by China and India, the 4th place – Brazil, 5th place – Russia.

Tax burden. 1st place – Russia, 2nd and 3rd places are shared by China and South Africa, 4th place – India, 5th place– Brazil.

Regulatory environment. 1st place – Russia, 2nd place – South Africa, 3rd – China, 4th place – Brazil, 5th place – India.

These data allow to judge about the competitive advantages of the countries concerned, which underlie their strategy to attract foreign direct investment (FDI).

COMPARATIVE COMPETITIVE ADVANTAGES

Brazil

Among BRICS countries, Brazil has high openness, low risk and good ratio of labor resources quality and cost of labor. These attractiveness factors are interrelated. The high openness of the economy allows foreign capital to operate in a wide range of industries, and low risks extend the range of foreign investors willing to implement projects. Good ratio of labor resources quality and cost of labor allows to maintain the efficiency of FDI projects in labor-intensive industries that require limitations of wages growth and technologically complex sectors that need highly qualified personnel.

However, FDI inflows to the country are constrained by the highest in the BRICS level of taxation and less strong positions in such realms as market size, infrastructure, financial market development and regulatory environment (Brazil there has the penultimate fourth place in the BRICS).

Russia

Russia leads in four of the ten components of the investment climate: infrastructure, quality of labor resources, ease of tax burden and regulatory environment. However, in such important components as market size and openness of the economy, the country is in the middle of the list (third place). This suggests that the investment climate in Russia is able to attract FDI that are focused on geographically broad markets, rather complex and high-tech production, reinvestment of profits and branch/public network. However, due to restrictions on FDI and average by the standards of the BRICS market, these opportunities are moderate.

The situation is complicated by weak financial market development (5th place) and quite significant risks (4th place), which are also aggravated by the sanctions of Western countries.

India

The country is a leader in low cost labor resources, protection of investments (1st place) and risks (shares 1st-2nd places with Brazil). India holds a strong 2nd place in terms of market size. This structure of competitive advantages in the field of investment climate shows significant potential for attracting FDI in labor-intensive industries and businesses oriented on the domestic demand. India is also attractive for investors focused on long-term projects and moderate risks.

Nevertheless, there are notable problems. The country occupies the last 5th place in the BRICS in infrastructure, quality of workforce and regulatory environment. Not too strong positions India has in openness of the economy (4th place) and ease of tax burden (4th place). Therefore, the investment climate in this country is dualistic in nature: along with the great opportunities it also creates great barriers.

China

China has leadership in the most important component – market size. It is the size of the market caused a strong attraction for FDI in China. However, it should be noted that in infrastructure and labor resources quality, the country has a strong 2nd place in BRICS, and divides 2-3 places in financial market development and tax burden. All of this suggests strong competitive advantages of China and its potential to attract large amounts of FDI.

The main constraints are openness of the economy and investment protection, in which China occupies the last 5th place in the BRICS.

South Africa

The country is a leader in openness of the economy and financial market development, ranked 2nd in investment protection and regulatory environment and shares the 2-3 places in ease of tax burden. The structure of competitive advantage is characteristic for smaller countries: the focus is on wide availability of the spheres of investments, support of investment process by the financial sector, tax incentives, maximum comfort in legal procedures and protecting the interests of the investor.

South Africa is behind the other BRICS countries in terms of market size and low cost labor resources, has a low 4th place in labor force quality. The ratio of labor resources quality and cost of labor in the country is most problematic in the BRICS. It does not support sufficiently neither labor-intensive nor technologically advanced industries.

FDI Inflow

Inflow volume

In a sense, the amount of FDI is "real" or "objective" assessment of investment climate in the country concerned. This assessment is not exhaustive, since FDI is strongly influenced by cyclical factors in the world economy and geopolitical situation. Therefore, the dynamics of the incoming flows of FDI need to be evaluated comprehensively.

As can be seen from table 2, in the period from 2010 to 2015, FDI inflows to the BRICS countries almost stabilized. However, the largest recipient of FDI – China – shows all the same some increase. This again suggests that market size is a priority component of the investment climate, which is able to compensate for even weaker positions in other separate components.

Table 2

FDI inflow in BRICS countries, million us dollars.

	2010 г.	2011 г.	2012 г.	2013 г.	2014 г.	2015 г.
Brazil	83 749	96 152	76 098	53 060	73 086	64 648
Russia	31 668	36 868	30 188	53 397	29 152	9 825
India	27 417	36 190	24 196	28 199	34 582	44 208
China	114 734	123 985	121 080	123 911	128 500	135 610
South Africa	3 636	4 243	4 559	8 300	5 771	1 772
Total:	261 204	297 438	256 121	266 867	271 091	256 063

Source: World Investment Report 2016. Investor Nationality: Policy Challenges. UNCTAD, Geneva, 2016.

More complicated the situation is with Brazil, which is in second place in the BRICS by the volume of attracted FDI. The maximum achieved in 2011 is almost 1.5 times higher than the figure of 2015. It is likely that Brazil will need some years to return to maximum values of FDI inflows. In the face of world growth slowing (not to mention the crisis) such components of investment climate as openness, good ratio of labor resources quality and cost of labor, investors protection, which are characteristic of Brazil, tend to play a lesser role than the market size. Therefore, Brazil may in terms of the volume of attracted FDI be closer to China mainly in periods of favorable world market.

In 2014 India came on the third place. Like China, India had the growth of FDI in recent years. As in China, this growth is due primarily to the significant size of market in the country. In India, however, there is another important component working effectively in a downturn of the world market – low costs of labor. India is successfully reducing the large gap in FDI inflows as compared with China – from more than five-fold gap in 2012 to approximately triple one in 2015.

In 2014-2015 Russia has experienced a dramatic decline in FDI inflows. A crucial role in it was played by the fall in oil prices and the complication of the geopolitical situation of the country, which entailed the introduction of Western countries anti-Russian sanctions. But the investment climate of Russia is quite competitive in the BRICS. Therefore, the fixing of oil prices above $60 per barrel and the lifting of sanctions can help the country to continue attracting FDI.

South Africa is characterized by strong fluctuations in FDI inflows from year to year. Thus, in 2010-2013, the inflow increased in the country 2.3 times, and for 2013-2015, fell 4.7 times. There is a strong dependence on the global cycle, immediate and dramatic reaction of FDI inflows to the deteriorating market conditions and falling raw material prices, which affect the main investment sector of South Africa – mining industry. The parameters of the investment climate of the country do not allow to absorb the external shocks because the competitive advantages of South Africa are just associated with the maximum openness of the economy, and the size of the market is the smallest in the BRICS.

Rating from investors

Assessment of business conditions in the recipient countries, generated by surveys of foreign companies' representatives working in the BRICS countries, in General confirms, but also supplements and updates the index the investment climate. Table 3 summarizes survey data of the World Economic Forum for the most problematic areas of doing business. It follows that in all the BRICS countries there are significant concerns of the business community with the problem of corruption. Mostly acute this problem is perceived in Brazil, and the least – in China. Other items of the questionnaire display the greater dispersion.

If you select the five most problematic areas in each BRICS country, the situation looks as follows. In Brazil, the 1st place is occupied by tax rates, 2nd place – corruption, 3rd place – tax regulations, 4th place – inefficient government bureaucracy, 5th place – policy instability.

Table 3

Most problematic factors for doing business, 2016.

	Brazil	Russia	India	China	South Africa
Tax rates	15,9	13,3	9,6	7,8	2,6
Tax regulations	12,5	7,7	11,7	7,5	0,8
Corruption	13,6	10,9	10,9	7,9	12,3
Inefficient government bureaucracy	11,9	6,0	3,5	8,7	17,7

	Brazil	Russia	India	China	South Africa
Policy instability	9,2	6,7	3,6	8,8	12,8
Restrictive labor regulations	8,7	2,7	4,4	4,0	17,5
Inadequate supply of infrastructure	7,8	4,3	4,2	6,8	4,2
Inadequately educated workforce	4,8	4,6	2,5	4,8	12,9
Access to financing	3,4	10,7	2,8	10,8	1,8
Government instability	3,4	3,1	5,7	4,0	1,5
Insufficient capacity to innovate	2,8	3,6	7,3	6,7	0,2
Inflation	2,5	13,8	7,4	8,4	1,7
Poor public health	1,7	1,0	8,5	2,8	0,6
Poor work ethic in national labor force	0,9	3,6	6,0	5,0	4,8
Crime and theft	0,8	2,9	7,4	1,9	6,9
Foreign currency regulations	0,2	5,2	4,6	4,0	1,7

Source: Global Competiveness Report 2016-2017. /ed. by Klaus Schwab/. Geneva, World Economic Forum, 2016.

In Russia: 1st place – inflation, 2nd place – tax rates, 3rd place – corruption, 4th place – access to financing, 5th place – tax regulations. It can be noted that the surveys show a worst performance of Russia in the field of tax rates as compared with evaluation given in the index of investment climate. This is partly due to the fact that the index in question takes into account only data on corporate taxes and indirect taxes, while in Russia are also important other taxes and contributions (e.g., contributions to social insurance funds). In addition, the perception of the tax burden is influenced by profitability of businesses: the same rate of corporate tax may be perceived as high for low-profit businesses and reasonable or even low for high-profit ones. Amid falling oil prices and Western sanctions the profitability of foreign companies in Russia was reduced.

India: 1st place – tax regulations, 2nd place – corruption, 3rd place - tax rates, 4th place – poor public health, 5th place - crime and theft.

China: 1st place – access to financing, 2nd place – policy instability, 3rd place – inefficient government bureaucracy, 4th place – inflation, 5th place – corruption.

South Africa: 1st place – inefficient government bureaucracy, 2nd place – restrictive labor regulations, 3rd place – inadequately educated workforce, 4th place – policy instability, 5th place – corruption.

As can be seen from the above data, the perception of business community holds tax rates and tax regulations as very problematic areas in three countries – Brazil, Russia and India. Inflation is perceived as the main problem in Russia. The inflation factor falls into the top five problem areas in China as well, but it ranks only fifth. The inefficiency of government bureaucracy is strongly emphasized as the main problems in South Africa, but also is noticeable in the survey data for China. Access to financing is perceived by investors as a major problem only in China. It is of importance also in Russia (fourth place).

Only in South Africa such problem areas as restrictive labor regulations and inadequately educated workforce are of great importance. In other BRICS countries, these areas were not included in the top five. And only in India among the first five areas of concern there are poor public health, and crime and theft.

Generally speaking, from the point of view of investors, the most typical country of the BRICS is Brazil. In this country the five most problematic areas at the same time rank among the five most problematic areas of the other BRICS countries. In other words, Brazil is kind of a mirror for BRICS. Its antithesis, in a sense, is South Africa. In South Africa the two most important problem areas are not among those ones in the other BRICS countries. Therefore, South Africa is the most specific BRICS country. Russia, India and China combine typical and specific problem areas, but they have only one specific problem area for each country.

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