FOREIGN POLICY AND POLITICAL DISTANCE IN THE INTERNATIONALIZATION OF BRAZILIAN FIRMS

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Estado e investimento estrangeiro: normas e instituições no debate contemporâneo

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17. Política Internacional, Relações Internacionais, Política Externa e Integração Regional
Please do not quote. This paper is a draft. The data set related to the work is in progress

Abstract

The relationship between the state and the national private capital is one of the driving elements of the division of political roles between different actors and social sectors and is essential to the understanding of the competitiveness of Brazilian companies. While there is a longstanding attention to the domestic effects of this relationship, little is known about the manifestations of this relationship beyond the national borders. Considering the political dimension as a key element of the organization and action of Brazilian companies, this work contains a proposal for systematization and analysis of the relationship between foreign policy and internationalization of Brazilian firms.

What is the role of foreign policy in the determination of Brazilian investments abroad? The paper will focus on delineating how and to what extent the Brazilian foreign policy strategies, international cooperation and bilateral relations, preferential agreements and investments - are intertwined with Brazilian investments. To do so, I propose one particular index to measure how different countries are related to Brazil between 2001 and 2014. Then, we will seek to present the mechanisms and how each of the political elements are predictive or explanatory factors of the locational decisions and entrance modes of Brazilian foreign investments.

This paper draft is the first effort of a work which intend to understand the link between business and Brazilian foreign policy. For this reason, I will: [1] present an overview of Brazilian foreign direct investments and the issues concerning politics and internalization of firms; [2] show the hypothesis and the research design; [3] explain how the data has been transformed to the construction of the index; [4] and, finally demonstrate some possible uses of the index for the analysis of Brazilian foreign direct investments.

Keywords: Political Distance; Brazilian multinationals; foreign policy, State-Business relations
INTRODUCTION

How Brazilian foreign policy is related to the Brazilian foreign direct investments? Companies and the Brazilian business interest organizations are active agents in programs of international cooperation and integration processes. They are also representatives of Brazil abroad. Its activities and decisions are favored or hindered by the actions of the Brazilian government, as well as the countries’ domestic and foreign policies in which they decide to invest or find business partners.

The relationship between Brazilian companies’ investment and the political dynamics of Brazil and others host countries are the main theme of this paper project. The main objective is to understand how Brazilian foreign policy affects the locational preference of Brazilian capital abroad. The hypothesis is the Brazilian direct investments are associated with political variables. Once the international affinities between the country and partners may mean credible guarantees to Brazilian investors, they create opportunities and reduce the risks associated with going abroad (the liability of foreignness). The political dimension can, therefore, be an important driver of investment decisions.

Brazil is a traditional receiver of foreign investment and only on the beginning of the XXI century it became a significant foreigner investor in comparison with developed countries (Motta Veiga and Rios 2014; Fleury, Fleury, and Borini 2013). The first destinations of the Brazilian investments were Latin America countries, much because to cultural proximity and similar socioeconomic characteristics (Fleury, Fleury, and Borini 2013). In recent years, especially since the Lula’s government (2003-2010), Brazilian companies began to penetrate other regions and are now present in most countries (Arbix and Caseiro 2011), surpassing the boundaries of its neighbors. As we can see in the figure above, Brazilian foreign direct investments faced a dramatic growth since 2003, partially because governmental incentives created in the beginning of the Labors Party government (2003).
There are many traditional explanations to the determinants of locational investments decisions. The most common way of understanding the internationalization of Brazilian companies is to comprehend it as a step after exports. In situations where markets have high share in exports of the company, the opening of subsidiaries, representative and technical assistance offices are seen as a naturals steps (CNI 2013, 45) \(^1\). Other frequent

\(^1\) See report (CNI 2013). Research CNI/MEI.
explanations comprehend the process 1. as a diversification’s strategy for the minimization of economic cycle risks (Hiratuka and Sarti 2011), the access to new technologies (Arbix, Salerno, and Negri 2005), 2. As a way of reduction of learning costs to deal with international competition (Cyrino and Tanure 2009); 3. As a consequence of the improvement of the macro and microeconomic institutional environments (Casanova and Kassum 2013) and; 4. As a result of foreign financing incentives (Caseiro 2013). Despite of all the concerns, the political dimension of the phenomena is still underrepresented in the literature.

Although little explored, political factors can be important determinants of investment’s decisions. In the domestic dimension, the democratization processes, the political orientation of governments, regulatory practices, decision-making processes, political instability, coups d’état, political crises and many other topics are triggered as explanations to the foreign investment locations and trade preferences (Busse and Hefeker 2007; Jensen 2008; Henisz 2000; Delios and Henisz 2003; Xu and Shenkar 2002). In the international dimension, free trade, preferential agreements and coalitions of interests in international bodies are examples of issues commonly highlighted in discussions about the dynamics of international economic relations and its possible effects on the course of international investments (Büthe and Milner 2014; Buthe and Milner 2008; Asiedu 2002; Ghemawat 2001).

The mechanism through the political dimension influences foreign investment may be expressed by the assumption that the proximity between states can affect the behavior of investors by facilitating interactions between economic agents and thereby reduce information asymmetries, reducing risks of expropriation and favoring investments (Gupta and Yu, 2007). In the case of US investments abroad, there is evidence that the political proximity of the host countries with the US reduces asymmetries and information costs for businesses and, consequently, the entry barriers (2007, p. 5). Similarly, the proximity may also reduce risks. While evaluating Chinese investments, Duanmu (2014) argues that the magnitude of the risk to which Chinese companies are submitted is associated with the strength of political relations between the Chinese government and the recipient countries. These explanatory mechanisms may also be indicative of Brazilian investments abroad.

Such gaps were justified until recently, as the Brazilian FDI was small. However, the increase of FDI in recent years and the expansion of state incentives dedicated to it granted relevance to this issue (Caseiro and Masiero 2014). In this sense, the
comprehension of the role of foreign policy over the internationalization of firms is a broad and prolific field of study. To address this question, I propose one particular index to measure how different countries are related to Brazil between 2001 and 2014. The (Brazilian) Foreign Policy Index (2001-2014), try to measure how different countries are related to Brazil in terms of foreign policy. The aim of the index-construction is present a useful tool that can be used as part of descriptive or inferential analysis. To the purpose of this work, the intention is to present an alternative to assess how the Brazilian foreign policy is related to Brazilian foreign direct investments.

**Hypotheses**

The hypothesis of this project seeks to encompass the main political dimensions involved in the strategic definition of the location and the type of Brazilian FDI. Firstly, they recognize that the international political alignment is an indicator of affinities between the Brazilian political interests and business strategies. In other words, this means that the shortest policy distance in international matters with respect to Brazil the greatest the attraction of Brazilian investments. In addition, Brazilian investments abroad may be determined by domestic features of the destination countries, once they present themselves as environments in which Brazilian companies can be competitive since they already operate (the adaptive risks and costs are reduced).

The general hypothesis is that the political distance affects the Brazilian foreign direct investments.

**H1:** The political engagement on international issues between Brazil and the host country induces positively the Brazilian direct foreign investments.

**H2:** The smaller the institutional distance of countries with respect to Brazil induces positively the Brazilian direct investments.

**How to assess foreign policy?**

If the concern about the Brazilian positions on foreign policy motivates the scrutiny of its possible effects, before we deal on them it is important to keep in perspective and understand how foreign policy is perceived and described. The search for indicators, so to speak, is an open and fertile ground for research. It is in this key indicator that this proposal is. The Foreign Policy Index attempts to combine efforts and literature suggestions to create an indicator that seeks to be both intuitive and representative time of action of the size spectrum and international institutional positions occupied by Brazil.
between 2001 and 2014. Assimilating the efforts of several researchers to codify and organize political data that could mean affinities and differences between countries, groups and regions in relation to Brazil, was tried here gather the positive characteristics of many of the indicators used in the literature, and combining them into a new indicator, mitigate biases and problems often pointed out.

The index was constructed from the organization and systematization of data for the 1998 to 2014 period, and the project is expected to continue coding on a yearly basis. It takes into account information on: (a) the presidential international trips; (b) the similarity of the pattern of voting between Brazil and the country of reference in the United Nations General Assembly; (c) the existence of a Brazilian embassy in the country; (d) the number of signed and existing bilateral agreements, by country and year; (e) the conventions signed by the Ministry of Foreign Affairs; (f) the country’s participation in regional integration mechanisms (MERCOSUR, UNASUR, CELAC, ACTO, LAIA); (h) the country’s participation in inter-regional mechanisms (BRICS, CPLP, IBAS, Africa-South America Summit, Summit of South American-Arab Countries); and (i) the degree of congruence between the country’s positions and Brazil’s in international financial institutions, including the International Monetary Fund, the World Bank and the World Trade Organization.

One concern in finding a way to measure the expression of the relationship between Brazil and countries and regions is to identify how different countries offer conditions that facilitate or hinder investments or exports. Intensity policy measures may interest the political risk assessment calculation associated with foreign policy on exports and international investments, to measure the effect of policy choices on sector opportunities, on exports or even locational decisions of business internationalization.

For obvious reasons, unlike the literature in political science and international relations, economics and international business literature has not given due attention to the possible effects of foreign policy on the behavior of companies and markets. Despite the gap between the disciplines, International Political Economy has fulfilled the role giving important contributions to formulated problems in business studies field. Centering politics at the center of concerns about the locational determinants of international direct investment, for example, Buthe and Milner (2014) demonstrate the effect of international agreements on the direction of international foreign direct investment flows, Biglaiser and DeRouen demonstrate how the North-American investments take advantage of foreign policy (2007) and Gupta and Yu show how bilateral agreements could guide the allocation of international investment (2007). For exports, the literature is most abundant in point out
how exports are facilitated by participation in international coalitions (Gowa and Mansfield 1993), and international agreements affect domestic regulations (Pinto 2010), as the ideology of the incumbent party affects the willingness to trade agreements (Milner and Judkins 2004), among others.

Although the significant works on International Political Economy, politics has no proper resonance in studies on internationalization, adaptation and operation of companies in international environments. Despite this divergence scope of guidance, the political dimension and comparisons between countries have significant appeal in the area of international business, which can be easily noticed by the abundance of initiatives in describing how distances between countries may affect the market behavior, in general, and businesses in particular.

Three perspectives of non-geographic distances - the psychological, cultural and institutional - permeate the international business literature (Newman 2012). Firstly, the psychic distance, usually formulated from surveys with decision-makers emphasize how differences between lifestyles consumer preferences, education, culture and social values are explanatory variables for the locational decision of firms (Johanson and Vahlne 1977). Secondly, the cultural distance studies (Hofstede 1986; Kogut and Singh 1988) attributes the differences between collective models of cultural distinction how companies internationalize (choice of destination countries, management models, among others). Very close to political science issues, works on institutional distance, in turn, try to capture how differences and similarities in education, political and legal system, level of industrialization, laws, regulatory frameworks and local state relations modes with business affect business decisions and often determine the business success (Ghemawat 2001; Kostova and Zaheer 1999; Xu and Shenkar 2002; Berry, Guillén, and Zhou 2010).

Among the initiatives of construction of institutional distance indicators the better known and used in international business literature is the one created by Berry et al. (2010). The index considers the uncertainty of political stability (measured by the number of independent actors with veto power, the state size (% of government spending on GDP), if the state is member of the WTO and the states participating in the same trade bloc. By calculating the indicator using matrices (Mahalanobis distance) from the listed variables for different countries, the authors developed the indicator, which is available for the years 1960 to 2012. Although the presence of political elements, it is clear that very little foreign policy is captured by the index.
Inspiring the creation of several indicators, Ghemawat (2001) model has become widespread for evaluation of international companies and savings behavior. The author formulates a framework to evaluate distances between countries - the CAGE model. The conceptual model comprises four distances: the cultural, administrative (colonial ties, currency share or political association, political hostility, government policies and institutional strength), geographic (be a remote country, border sharing, lack of rivers or access to the sea, the country's size, difficulty of transport and communication lines, climate differences) and economic (consumer income, costs and quality of natural resources, human resources, financial resources, infrastructure, intermediate inputs, information or knowledge). Despite being widely used as a conceptual model, there are no clues on how the author calculates their distance and the operationalization of the perspective is at the discretion of researchers. And many attempts have been tried.

There is an open flank for the study of political distances between countries that emphasize foreign policy issues. It is expected that the proposed index can add the search to connect Brazilian external policy to the behavior of companies and the market.

**Foreign Policy Index**

The use of composite indexes that express the political distance between countries is common in disciplines as diverse as political science and international relations, economics, management and law (Ghemawat 2001; Berry, Guillén, and Zhou 2010; Newman 2012). Common to all indexes lies a problem of justification of the use of indicators which compose it, and the methodical technique to build the index. This is a critical aspect, as the partiality of choice or its suitability as a valid tool for empirical analysis are usually subject to criticism.

As a social phenomenon, a public policy can be understood as a combination of actions, ideas and interests and a result of the social relations between individuals, institutions and, in the case of the foreign policy, of countries. Being an inherently contested concept, the empirical codification of a policy action is a risky act. Assuming the risk associated with the construction of a composite index we attempt at contributing to the empirical representation abstract actions in the field of International Relations. We are convinced that an effort for more empirical rigor is needed in the general field of International Relations, particularly as it is currently carried out in South American countries (Medeiros et al. 2016).

The idea of political distance assigns values to deeds and external commitments. It can be understood in two ways: as an indicator of affinity or distance, this is subject to the
interpretation of the investigator. What it is not subject of free interpretations is the fact that the composite index ranges from 0 to 1, 0 being the lowest possible value and 1 its maximum value.

The result is derived from a Factor Analysis, a method that, taking into consideration the variance of the sample data for each of the years, allows the production of annual rates. The step by step transformation of the variables and the in-depth description of the method for the construction of the indicator is not present in the appendix of the article (ask if interested). The results is a political distance index of 192 countries with regard to Brazilian Foreign Policy, for each of the years between 2001 and 2014. Table 1 summarizes the variables incorporated in the index.

### Table 1: Variables in the Foreign Policy Index

<table>
<thead>
<tr>
<th>Variable</th>
<th>Description</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>International trips</td>
<td>Official visit of the President of the Brazilian Republic. Values 0 or 1. 1998-2014.</td>
<td>Presidency website (Brazil)</td>
</tr>
<tr>
<td>Embassies</td>
<td>Embassies of existence in a given year. Values 0 or 1. 1998-2014.</td>
<td>Ministry of Foreign Affairs (Brazil) and Official Journal (Brazil)</td>
</tr>
<tr>
<td>Bilateral treaties</td>
<td>Quartile in which is the number of bilateral agreements each year. Values 0, 0.3, 0.6 and 1. 1998-2014.</td>
<td>Ministry of Foreign Affairs (Brazil)</td>
</tr>
<tr>
<td>Cooperation</td>
<td>If the country is host of a cooperation mission or a bilateral cooperation project in a given year. Values 0 or 1. 1998-2014</td>
<td>Ministry of Foreign Affairs (Brazil) and Brazilian Cooperation Agency</td>
</tr>
<tr>
<td>Programs lead by the</td>
<td>Quartile in which is the monetary value of cooperation programs lead by the Foreign Affairs Ministry each year. Values 0, 0.3, 0.6 and 1. 1998-2014.</td>
<td>Transparency Portal (Brazilian Government)</td>
</tr>
<tr>
<td>Foreign Affairs Ministry</td>
<td>Participation as full member in MERCOSUR per year. Values 0 or 1. 1998-2014.</td>
<td>MERCOSUR and the Ministry of Development, Industry and Trade (MDIC)</td>
</tr>
<tr>
<td>MERCOSUR</td>
<td>Quartile in which is the number of co participation in forums and regional integration organizations each year. It ranges from 0 to 1. 1998-2014.</td>
<td>Ministry of Foreign Affairs (Brazil), Official pages of Unasur, ACTO, LAIA and ECLAC.</td>
</tr>
</tbody>
</table>
Inter-regional arrangements
Quartile in which is the number of co-participation in the inter-regional mechanisms each year. It ranges from 0 to Ministry of Foreign Affairs (Brazil). Official pages of the BRICS and CPLP organizations. 1. 1998-2014.

Convergence in International Financial Institutions
Measure for the support to the Brazilian representation in the executive boards of the IMF, World Bank and co-participation in coalitions which Brazil belongs within WTO. It ranges from 0 to 1. 1998-2014. Official pages of the International Monetary Fund, the World Bank and the World Trade Organization.

Source: the author

Describing the Index

When considered as a whole, the indicator expresses on a yearly basis the intensity of Brazilian Foreign Policy engagement with 192 countries in the World. When considered on a country level the index is descriptor of Brazilian international affinities on a certain year. Our findings confirm two stylized conclusions in the literature: First, when analyzing the index as a whole, we observe that Lula’s second mandate was the most intense (particularly 2010) in terms of Foreign Policy activities (Figure 1). Lula had as one of its major priorities to Position Brazil globally but that effort vanished during Dilma’s first mandate.

Figure 3: Mean intensity of Foreign Policy along the years

Source: Rodrigues and Urdinez (2016, forthcoming)

Between 1998 and 2014, Brazil has enlarged and diversified its foreign policies. The trajectory of crescent insertion on international scene can be traced back from the Fernando Henrique Cardoso (1995-2002), mainly during his second mandate. The literature
frequently attribute to Fernando Henrique some changes in foreign policy orientation towards a wider set of partners and an active participation in international arenas. By the expression “autonomy by integration”, Lampreia (1998) summarizes the subjacent strategy, which consists, roughly, in the desire in increase Brazil’s role in the international arena by supporting multilateral institutions. According to Vigevani, Oliveira and Cintra (2003), in the period, the Brazilian government acted to build up regional initiatives, as MERCOSUR, and made efforts to an active participation in multilateral organizations.

**Figure 4: Brazilian Political Distance Index 2001**

![Brazilian Political Distance Index 2001](image)

Source: Rodrigues and Urdinez (2017, forthcoming)

The effects of the movements favoring a greater integration during Fernando Henrique Cardoso are reflected by the index. The upward trajectory of the means started in 1999 until 2011 (figure1) indicates the intensification of bilateral and multilateral activities in the period. This reflects the overall interaction with countries around the world, but not necessarily mean the pattern is the same for countries and specific regions. Despite the fact of the period’s political intensity incremental growth, only in Luis Inacio Lula’s government is possible to see a significative change in the index’s amplitude.

The Lula da Silva’s government is frequently quoted as the most intense in terms of foreign policy. Throughout it's years, Brazil increased its presence in the world by the opening of 3X embassies, by the establishment of cooperation partnership in Latin American and African countries, by the engagement in Global-South multilateral initiatives as the IBAS Dialogue Forum, the BRICS, the Summit South American-Arab Countries, the Africa-South America Summit, the Community of Portuguese-Language Countries (CPLP) and regional initiatives as UNASUR, and by the ability of coalition-construction inside financial organizations as IMF, World Bank and WTO. As shown by figure 1, Lula’s
bilateral and multilateral political entrepreneurship reached a peak during its second term (2007-2010). This is consistent with most foreign policy analysis about the period and denote the reason why Lula’s government in comprehended as a distinguished foreign policy paradigm (Vigevani and Cepaluni, 2007).

**Figure 5: Brazilian Political Distance Index 2010**

![Brazilian Political Distance Index 2010](image)

Source: Rodrigues and Urdinez (2017, forthcoming)

In opposition to the previous terms, the representation of Dilma Rouseff’s government is perceptively stable. In terms of change, Dilma seems to be the most predictable. The flat line means that almost nothing new occurred in the period. Part of this result is justified by the reduction of foreign activities and little engagement in multilateral forums (Cervo and Lessa, 2014). In spite of the reduction of variability in the index mean, the period is represented in a superior level in comparison to Fernando Henrique Cardoso term, much because of the legacy of the former government. Opened embassies, cooperation projects and multilateral engagement from previous mandates result in a higher insertion than the first years of the serie.

**RESEARCH DESIGN**

**The First Steps: two simple models to test the utility of the Index**

Foreign direct investment is the most commonly used indicator in analyzes to make inferences about the international presence of an economy. One possible option is to work with stock investments instead of investment output. This can be considered a better alternative since this variable is less susceptible to rapid changes from year to year. Data collection of Brazilian investments abroad is being held from information provided by
agencies and public and international bodies such as the Central Bank of Brazil, UNCTAD, ECLAC, LatinTrade, the World Bank and the WTO.

In order to measure the effects of political and institutional dimensions of the Brazilian FDI, I am organizing the data in panel (or Time Series Cross-Section, or TSCS)\(^2\), for the period between 2001 and 2014, from a sample that considers 192 countries, 130 of them recipients of Brazilian FDI in the period. The panel will be used to evaluate how the variation of Brazilian foreign policy toward countries, formal and informal political groups and regions affect the location of Brazilian FDI. Above I present some simples panel tests considering traditional control variables.

Model 1 - Simple test about the effects of Political Distance on Brazilian FDI - PCSE

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Standard Error</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lagged FDI</td>
<td>0.8675**</td>
<td>(0.03)</td>
</tr>
<tr>
<td>(log) GDP</td>
<td>0.3055**</td>
<td>(0.07)</td>
</tr>
<tr>
<td>(log) Population</td>
<td>-0.198**</td>
<td>(0.05)</td>
</tr>
<tr>
<td>Political Engagement</td>
<td>1.3037**</td>
<td>(0.36)</td>
</tr>
<tr>
<td>Adjusted R-Squared</td>
<td>0.8631</td>
<td></td>
</tr>
<tr>
<td>No. Observations</td>
<td>2486</td>
<td></td>
</tr>
</tbody>
</table>

\( * p<0.05; ** p<0.01 \)

Model 2 - Simple test about the effects of Political Distance on Brazilian Exports - PCSE

\( ^2 \) See (Beck and Katz 1995; Beck 2008) and (Maoz and Russett 1993).
As we can see, the first results seems to present a general idea that foreign policy is related to brazilian FDI. The models showed are very simple and much has to be done until any satisfactory result be presented. From now, I’m working on this.

Evolution of political distance over time – political groups and specific countries

Source: the author

**Models to be tested:**
1. Two steps - Heckman
It considers, per year, how the incremental growth of Brazilian FDI has been distributed among the countries.
H1: the greater the Brazilian foreign policy engagement with a country, the greater the share of Brazilian FDI.

2. Panel Corrected Standard Errors (PCSE)

It considers the stock of Brazilian FDI.

H2: Brazilian foreign policy engagement with a country is positively correlated to the increase of Brazilian FDI in such country.

**BASIC REFERENCES**


