ATLANTIC FUTURE

SCIENTIFIC PAPER

02

Commercial Ties in the Atlantic Basin: The Evolving Role of Services and Investment

Daniel S. Hamilton and Joseph P. Quinlan[1]

Center for Transatlantic Relations at Johns Hopkins University's School of Advanced International Studies

ABSTRACT

More services and investments flow among economies within the Atlantic Hemisphere than among those in the Asian Hemisphere. Services are the sleeping giant of the pan-Atlantic economy. The Atlantic is home to the world's major services economies; Atlantic economies are each other's most important services markets; and Atlantic economies are poised to be major beneficiaries and drivers of the growth in global services.2 Services are not just a North Atlantic story; they represent a growing area of commercial activity among Southern Atlantic countries as well. particularly in energy-related services; engineering and construction services; and education and managerial services. The United States and Europe are global leaders as outward investors and recipients. But today a rising global share of FDI emanates from the developing nations. And whereas trade and investment ties, and bank lending, between these nations and Africa and South and Central America were once shallow and underdeveloped, such linkages are now thicker, more robust and more sophisticated, particularly from China. But the EU remains the largest source of FDI on all Atlantic continents. It is also the largest holder of portfolio assets in North America. Its assets in Africa are roughly equal to those of Asia. North America accounted for over half of South and Central America's portfolio holdings in 2012, with the EU the only other major asset holder. South and Central America's holdings in North America and Europe grew rapidly over the past decade, although from a low base. All told, the Atlantic Hemisphere accounted for 83.8% of EU portfolio assets and 70.2% of North American portfolio assets in 2012.

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[1] Daniel Hamilton is the Austrian Marshall Plan Foundation Professor and Director of the Center for Transatlantic Relations at Johns Hopkins University's School of Advanced International Studies. Joseph Quinlan is a Senior Fellow at the Center.

[2] The gains stemming from the liberalization of services could potentially be larger than in all other areas of international trade.

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1. Introduction

Commerce in the Atlantic Basin presents a mixed picture. Commercial ties between the United States and Europe, for instance, are among the deepest and thickest in the world. U.S. and European commercial ties with South and Central America are also substantial. In contrast, the linkages between the U.S. and Africa, and between Latin America and Africa, while expanding, are still comparatively thin and underdeveloped. And while Europe's commercial links to Africa are significant, its relative importance is shifting as other actors appear on the scene.

Trade in merchandise goods is the primary means by which the Atlantic Basin is stitched together. These linkages are being addressed in other papers. But regional ties are also becoming deeper via rising trade in services, greater cross-border foreign direct investment (FDI), and increasing capital flows. This paper examines these metrics.

2. Services

Services are the sleeping giant of the pan-Atlantic economy. The Atlantic is home to the world's major services economies, and Atlantic economies are each other's most important services markets.[3] Global trade in services is still less important than trade in goods, since many service activities require a local presence and many countries impose restrictions on services trade. Nonetheless, services trade has intensified and is set to expand rapidly, and Atlantic economies are poised to be major beneficiaries and drivers of the growth in global services, since they are the most competitive services economies in the world.[4]

The United States is the largest single country trader in services, while the EU is the largest trader in services among all world regions. Most American and European jobs are in the services economy, which accounts for over 70 percent of U.S. and EU GDP. Over half of U.S. and EU services exports go to Atlantic Basin countries,[5] and each is seeing an increasing share of its services trade conducted with Latin America and Africa. Moreover, the delivery of services by foreign affiliates -- driven by pan-Atlantic investments -- has exploded over the past decade and is far more significant than services trade. The U.S. and EU each owe a good part of their competitive position in services globally to deep Atlantic connections in services industries provided by mutual investment flows. A good share of U.S. services exports to the world are generated by U.S. affiliates of European multinationals, just as a good share of EU services exports to the world are generated by European affiliates of U.S. multinationals.[6]

Services are not just a North Atlantic story. Services are far more important to Atlantic economies such as Brazil, South Africa, Mexico and Colombia than to non-Atlantic economies such as Russia, India or China. Brazil's expanding services industry contributes about two-thirds of its total GDP and employs about 70 percent of its labor force. Services account for more than 50 percent of GDP in Africa's 36 non-resource-rich economies and for more than 40 percent of GDP -- more than industry's share -- in

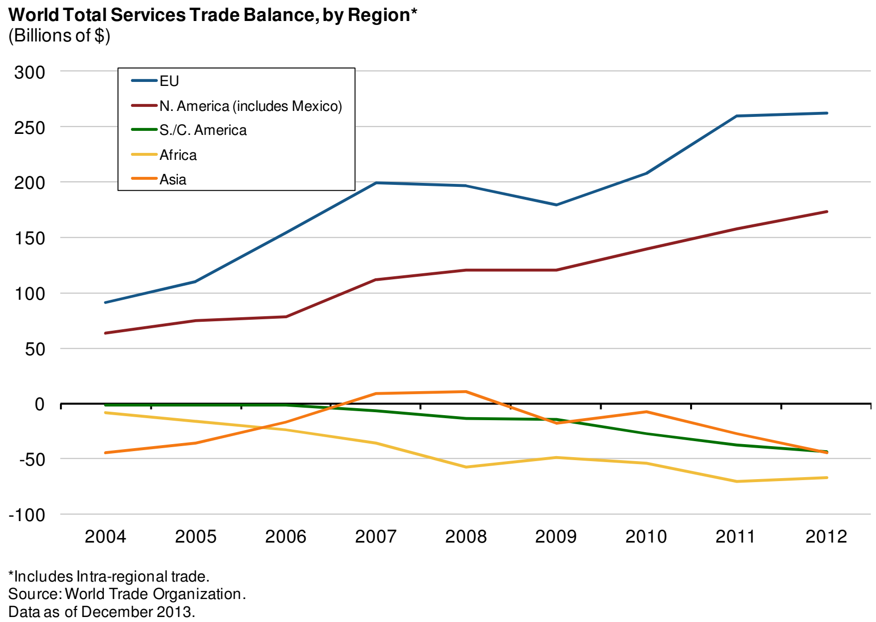
[3] While the services sector accounts for only 23% of global exports, it accounts for over 70% of GDP in advanced economies. Martin Wolf, *Why Globalization Works.* New Haven: Yale University Press, 2004.
[4] The gains stemming from the liberalization of services could potentially be larger than in all other areas of international trade.
[5] Eurostat.
[6] Daniel Hamilton, *Europe 2020 -- Competitive or Complacent?* Washington, DC.: Center for Transatlantic Relations, 2011.

the continent's resource-rich economies. As income per capita in Latin America and Africa grows, and as governments seek to diversify their economies away from commodity production, demand will grow for such services as health care, education, entertainment, insurance, telecommunications and finance. Moreover, services is a growing area of commercial activity among Southern Atlantic countries, particularly in energy-related services; engineering and construction services; and education and managerial services.[7]

Services have also come to dominate global foreign direct investment over the past decade, with Europe at the forefront, driving this process. Today, services represent nearly two-thirds of global FDI stock, up from a 49% share in 1990. Whereas services FDI used to be strongly related to trade and trade-supporting services for manufacturing multinationals, over the past decade more services FDI has been directed at such activities as hotels, restaurants, and financial services. Electricity, water, telecommunications and other infrastructure-related activities have also been receiving more foreign direct investment.[8]

A number of factors have lead to a rise in services FDI. The first has to do with the ascendancy of the services economy, not only in developed countries but around the world. Second, since many services are not tradable, cross-border investment is the only way to bring services to foreign customers. In addition, services FDI has expanded as more firms seek out new markets and new resources outside their home base. Finally, more Free Trade Agreements (FTAs) are centered on services, promoting greater cross-border investment in various service activities.[9]

Figure 1. World Total Services Trade Balance, by Region



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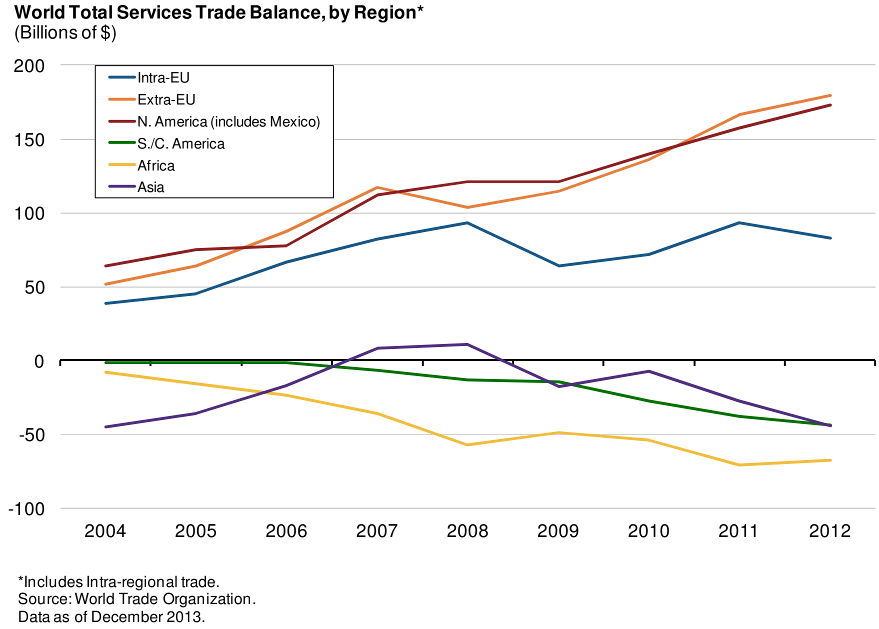
[7] Even in resource-rich economies in Africa services between 1999 and 2008 came to account for over 40 percent of GDP, more than industry. See Uri Dardush and William Shaw, *Juggernaut - How Emerging Markets are Shaping Globlization.* Washington DC Carnegie Endowment for International Peace, 2012, p. 186.; http://www.economywatch.com/world_economy/brazil/structure-of-economy.html.
[8] OECD.
[9] WTO; Daniel S. Hamilton and Joseph P. Quinlan, *Globalization and Europe*. Washington, DC.: Center for Transatlantic Relations, 2008, p. 75; http://trade.ec.europa.eu/doclib/docs/2010/june/tradoc_146270.pdf

Figure 2. World Total Services Trade Balance, by Region [indicating intra-regional trade]



As Figures 1 and 2 indicate, North America and the EU are highly competitive services economies and consistently record global services trade surpluses, while Asia, Africa and South and Central America each record global services trade deficits.

Figure 3. World Total Commercial Services Exports, by Region

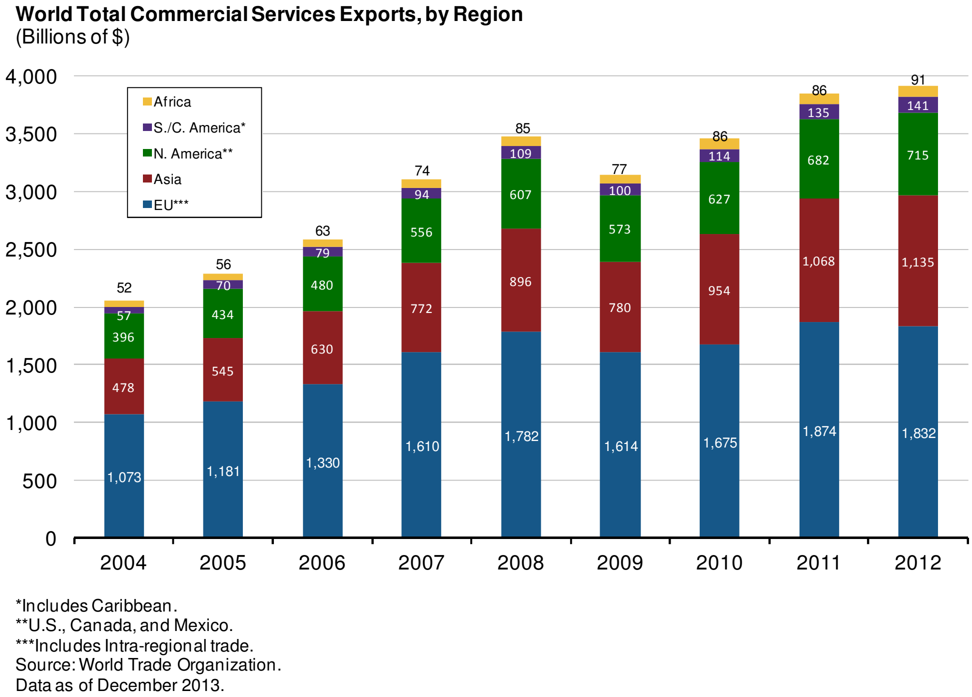
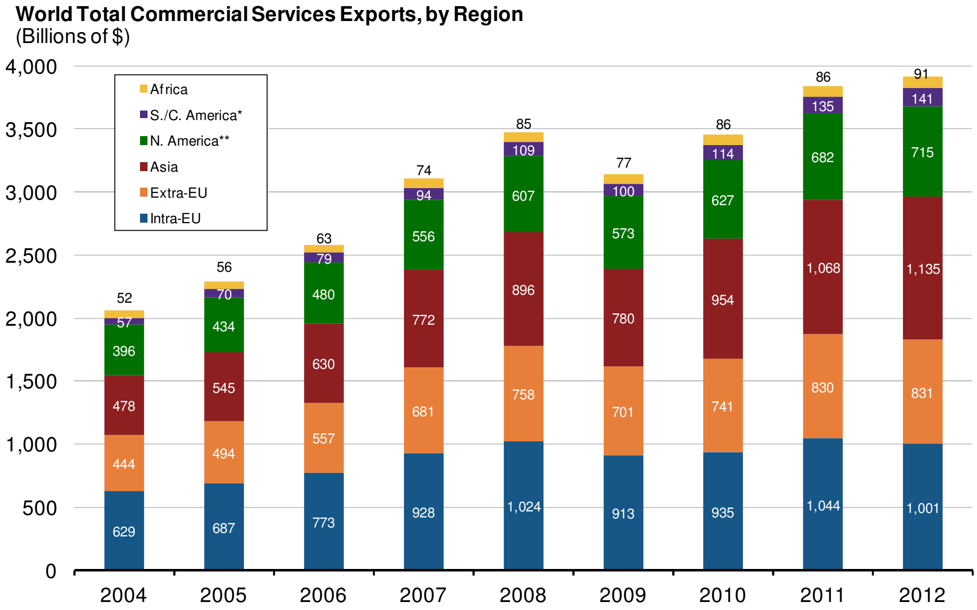


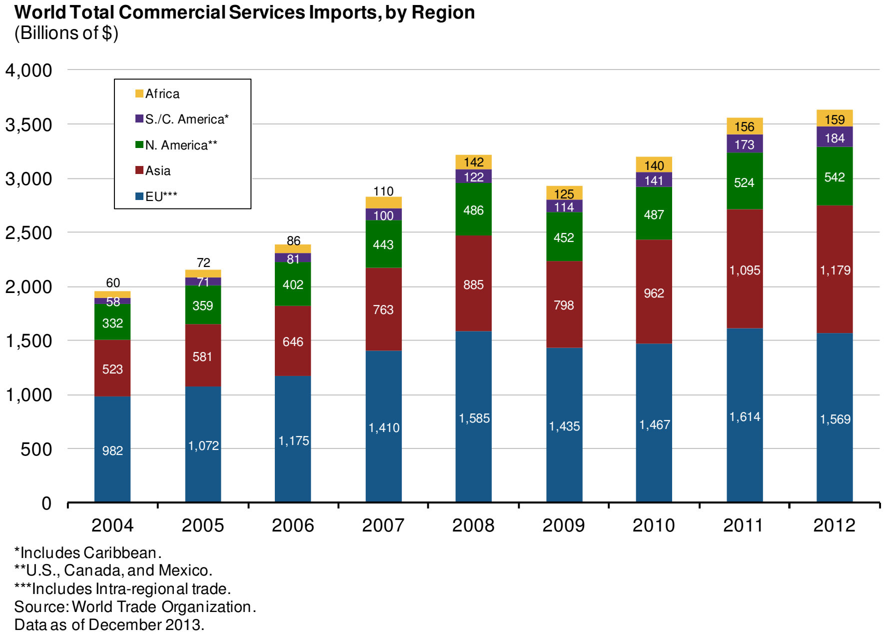
Figure 4. World Total Commercial Services Exports, by Region [including intra-regional exports]



*Includes Caribbean.
**U.S., Canada, and Mexico.
Source: World Trade Organization.
Data as of December 2013

In 2004, EU commercial services exports were double those of Asia and North America, and in fact were more than combined commercial services exports from Asia, North America, South and Central America and Africa. In 2012 the EU still the major global commercial services exporter, although recording slightly less than double Asian exports. North America's position as a commercial services exporter, in contrast. slipped relative to Asia. However, as Figure 4 indicates, over half of EU commercial services exports re within the EU itself. The EU exports slightly fewer commercial services to the rest of the world [excluding Russia and neighboring countries] than Asia, although more than North America, South and Central America, and Africa.

Figure 5. World Total Commercial Services Imports, by Region



In 2004, EU imports of commercial services were about twice those of Asia and almost triple those of North America. In fact, EU imports were more than combined commercial services imports of Asia, North America, South and Central America and Africa combined. In 2012 the EU was still the largest importer of commercial services, still about triple North American imports, but Asian imports grew relative to EU imports. but now accounting for less than double Asian imports. North American, South and Central American services imports tripled, but from a low base. African imports grew more than 2.5 times over this period, but also from a low base.

However, as Figure 6 indicates, most EU commercial services imports were from other EU countries. The EU imported fewer services in 2004 from the rest of the world [excluding Russia and neighboring countries] than did Asia and about the same as North America and South and Central America combined, or North America and Africa combined.

Figure 6. World Total Commercial Services Imports, by Region [including intra-regional imports]

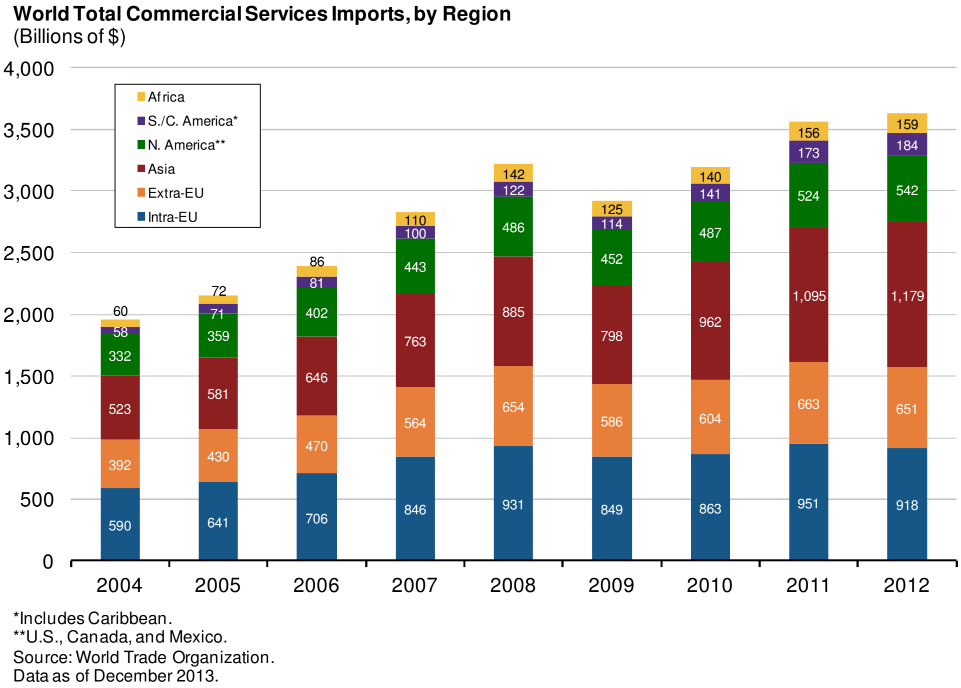
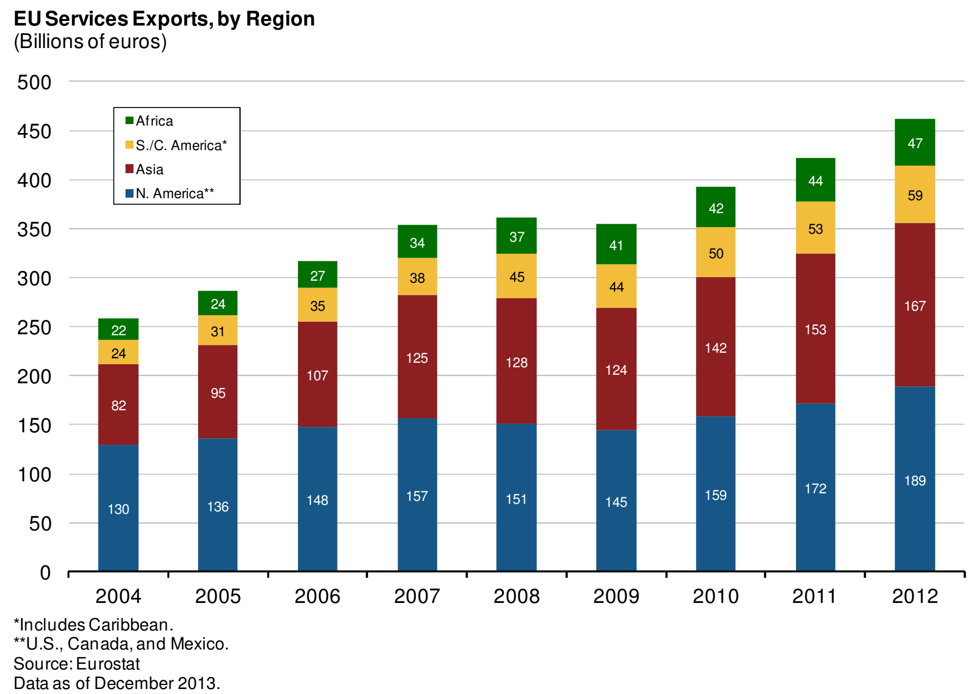
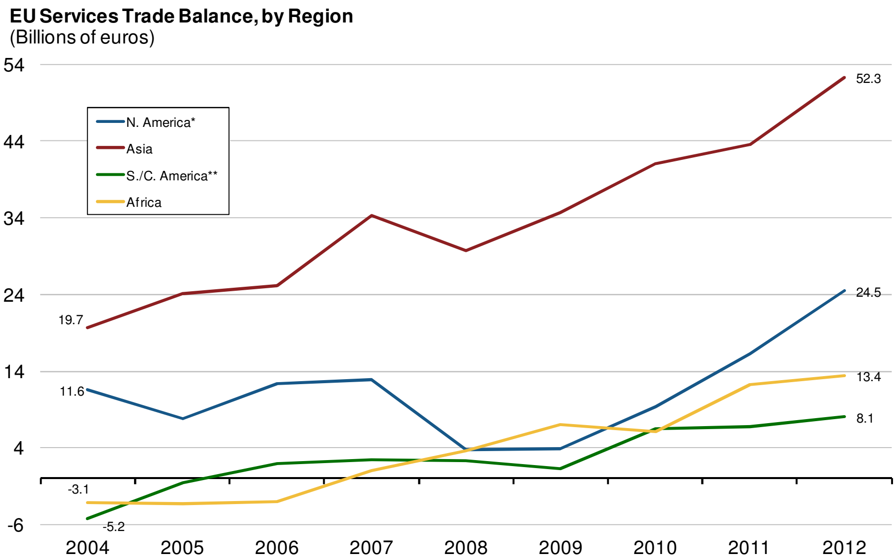


Figure 7. EU Services Exports, by Region



In 2004 more than one-half of EU services exports went to North America, followed by Asia and then roughly equal shares to South and Central America and Africa. By 2012 North America was still the leading customer of EU services exports, but Asia, South and Central America and Africa had each increased its relative share of EU services exports, cutting into the North American share.

Figure 8. EU Services Trade Balance, by Region



*U.S., Canada, and Mexico.
**Includes Caribbean.
Source: Eurostat.
Data as of December 2013.

The EU registers services trade surpluses with South and Central America and Africa. It consistently registers particularly high services trade surpluses with Asia -- €52.3 billion in 2012. It also registers consistent services trade surpluses with North America while recording services trade deficits with the United States, indicating that EU services trade surpluses with Canada and Mexico are relatively high.

Within the Atlantic Hemisphere, North America's share of EU services exports, while predominant, declined from 73.8 percent to 64.2 percent between 2004 and 2012. Africa's share, in contrast, rose from 12.4 percent to 15.9 percent, and South and Central America's share climbed from 13.8 percent to 19.9 percent over this period -- see Figures 9 and 10.

Figure 9. Percentage of EU Services Exports to Atlantic Basin, by Destination, 2004

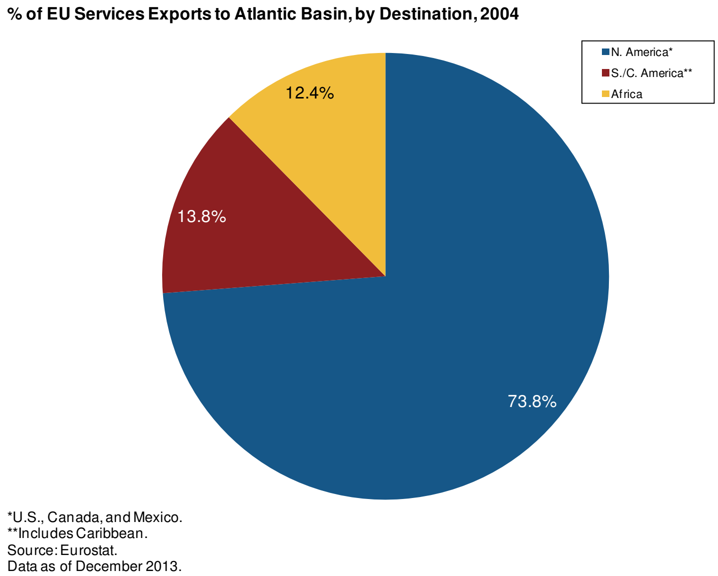


Figure 10. Percentage of EU Services Exports to Atlantic Basin, by Destination, 2012

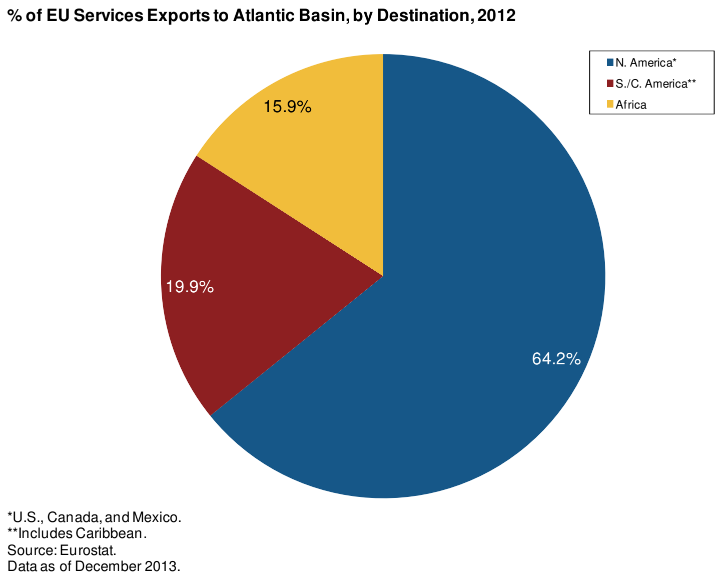


Figure 11 indicates that in 2004 European services companies exported about 58 percent of their services within EU borders and only 42 percent outside the EU, whereas by 2012 the intra-EU figure had fallen to just under 55 percent and the extra-EU demand had risen to just over 45 percent of total services exports. This seems to be largely explained by the enduring European recession, as the relative shift coincided with the onset of the financial crisis in 2008-2009. EU services imported from within the EU accounted for just over 60 percent of overall EU services imports in 2004, and had declined only slightly by 2012.

Figure 11. The Importance of Intra-EU Services Trade

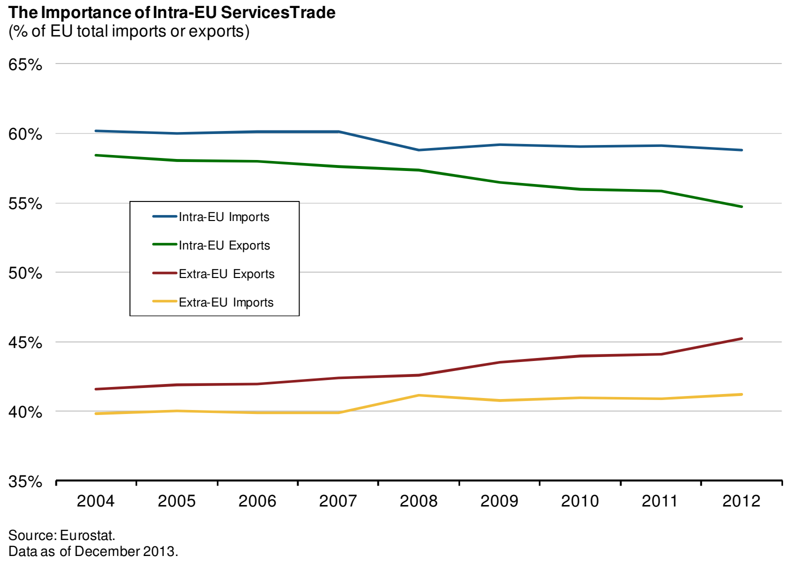
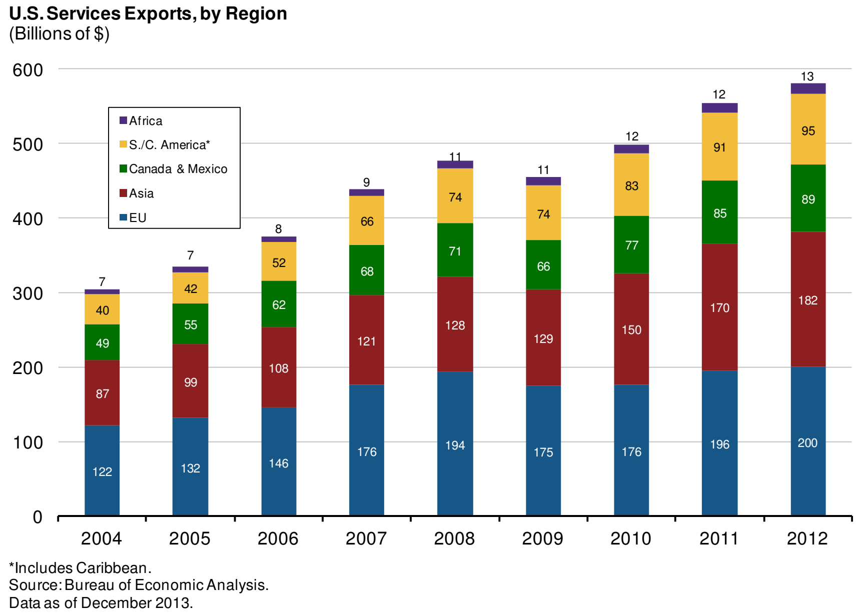


Figure 12. U.S. Services Exports, by Region



Between 2004 and 2012 U.S. services exports almost doubled, with the EU as the primary destination. The U.S. records consistent services trade surpluses with the EU and all other regions; its services trade surplus with Asia is particularly large and rising. The U.S. is particularly competitive in exports of royalties and license fees. U.S. exports of business, professional and technical services are substantial as a relative share of U.S. exports of "other private services" to all regions. Financial services exports are particularly important to Europe, educational services exports are particularly important to Asia, and exports of telecommunications services are particularly important to South and Central America.

The EU remains the primary destination of U.S. services exports globally as well as within the Atlantic Hemisphere, although its relative share within the Hemisphere declined from 56 percent in 2004 to 50.3 percent in 2012, whereas South and Central America's share rose from 18.3 percent to 23.9 percent and the relative shares of Africa and Canada/Mexico were stagnant.

Figure 13. U.S. Services Trade Balance, by Region

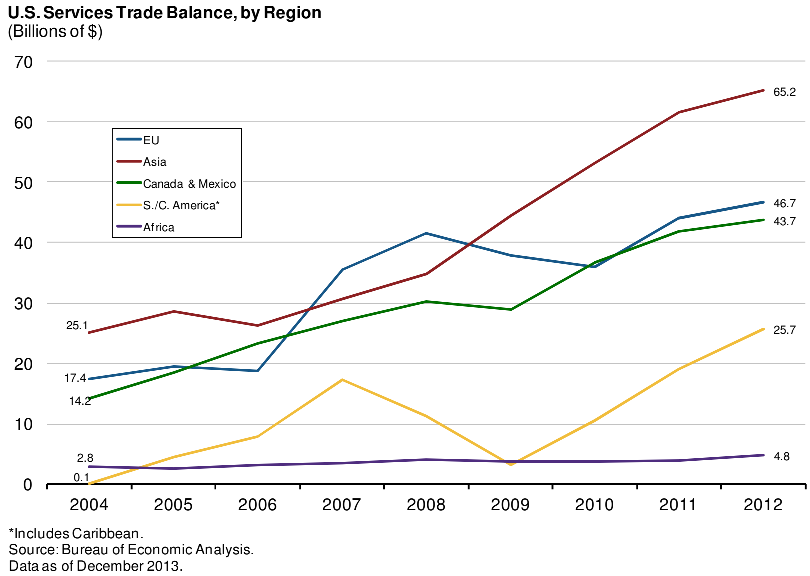


Figure 14. Percentage of U.S. Services Exports to Atlantic Basin, by Destination, 2004

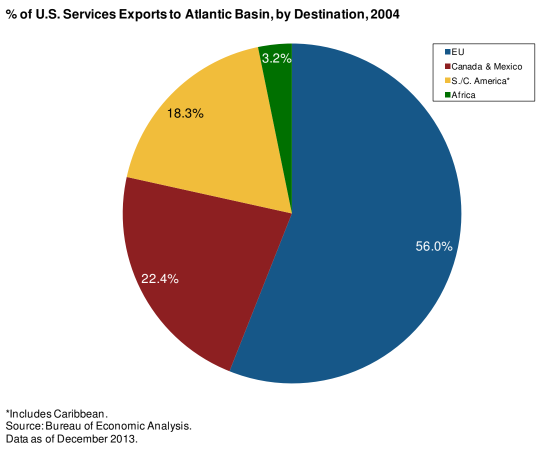


Figure 15. Percentage of U.S. Services Exports to Atlantic Basin, by Destination, 2012

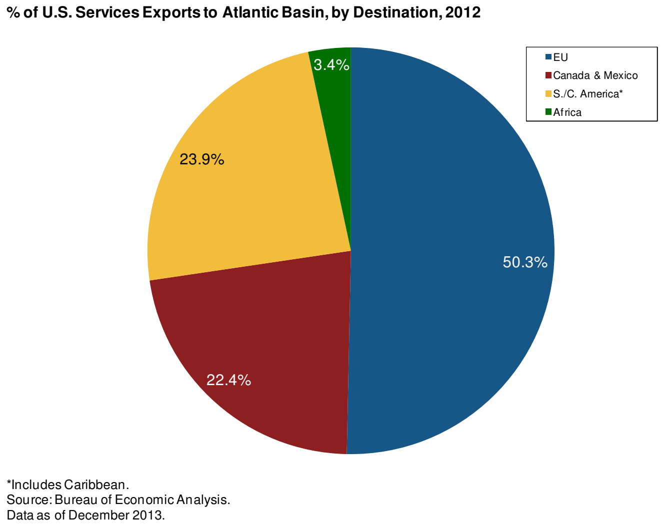


Figure 16. U.S. Exports of Royalties and License Fees, 2012

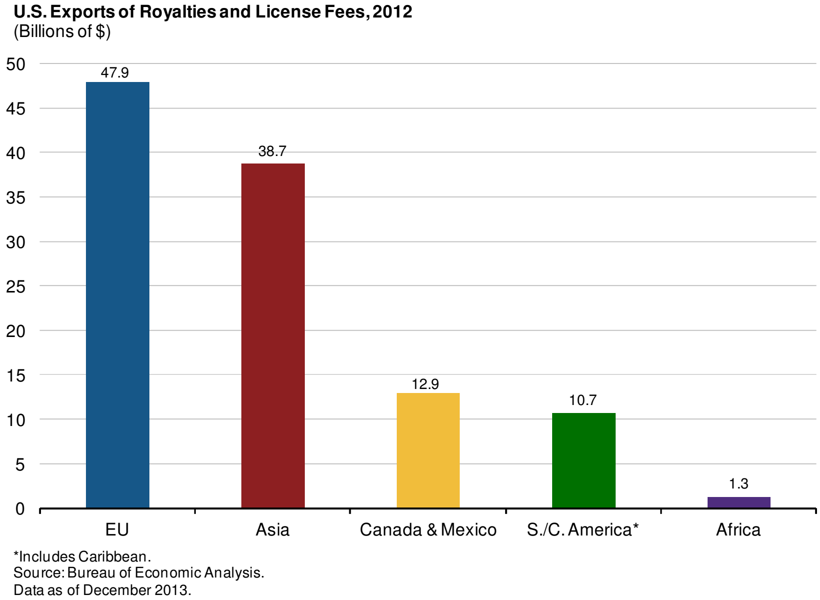
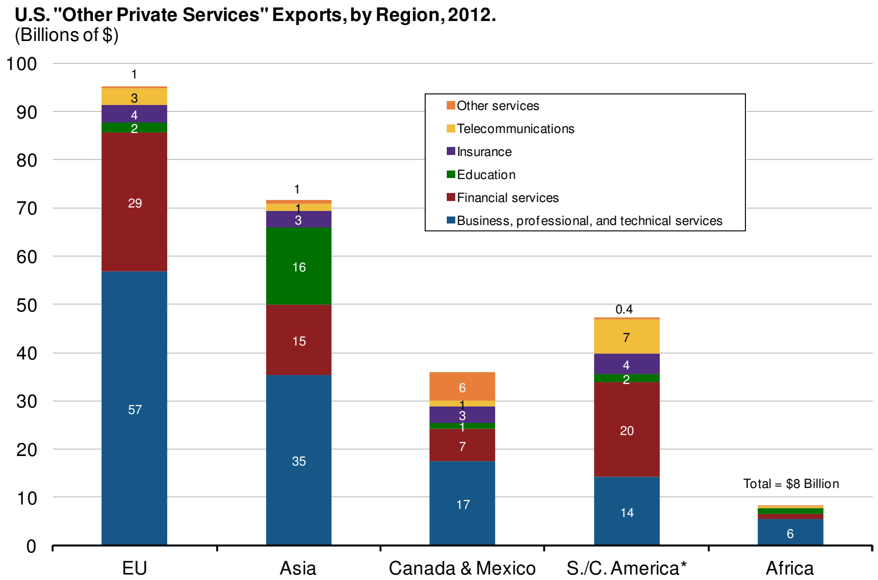


Figure 17. U.S. Other Private Services Exports, by Region, 2012



*Includes Caribbean.
Source: Bureau of Economic Analysis.
Data as of December 2013.

3. Foreign Investment Flows in the Atlantic Basin

Of the four regions of the Atlantic Hemisphere—defined here as North America, South and Central America [including Caribbean], Europe and Africa—direct foreign investment is primarily geared towards the developed markets of North America and Europe. This is to be expected—global foreign direct investment flows have a strong developed-nation bias given the preference of multinationals to invest in large, open, and wealthy markets that adhere and uphold strong intellectual property rights and abide by a transparent rule of law. Skilled labor is another determinant of foreign direct investment, which invariably means more investment between and among the United States, Canada and Europe.

As specifically outlined and discussed in our annual survey of the Transatlantic Economy,[10] the foreign direct investment ties between the United States and Europe are the deepest and thickest in the world. Hence, FDI flows in the Atlantic Hemisphere exhibit a strong North Atlantic bias. However, both South America and Africa have attracted more investment from the United States and Europe over the past decade thanks to stronger levels of growth and the rising number of middle class consumers, strengthening north-south investment ties and deepening the commercial linkages of the Atlantic Basin.

3.1 Making Room for Asian Economies

While the United States and the EU still exert a powerful influence over their partners in the Atlantic Basin, it is important to note the increasing role being played by China and

[10] See Daniel S. Hamilton and Joseph P. Quinlan, *The Transatlantic Economy 2014: Annual Survey of Jobs, Trade and Investment between the United States and Europe* (Washington, DC: Center for Transatlantic Relations, 2014), and previous editions available at http://transatlantic.sais-jhu.edu.

India, as well as countries such as South Korea and Japan, in South and Central America and Africa. The depth and thickness of Atlantic Basin commercial ties will be influenced, if not diluted, by the growing presence of these and other non-Atlantic economies in both regions. This section briefly summarizes this dynamic.

For starters, whereas for decades the bulk of foreign direct investment (FDI) flowed to and from the developed nations, today a rising global share of FDI emanates from the developing nations. Global FDI increasingly bears the hallmark of global-minded corporate giants from Brazil, China, Russia and India. And where trade and investment ties, and bank lending, between these nations and Africa and South and Central America were once shallow and underdeveloped, such linkages are now thicker, more robust and more sophisticated.

A significant challenge to the notion of an integrated Atlantic Basin is this: the expanding commercial ties of two of the largest emerging economies in the world, China and India, with two of the largest emerging regions of the world, Africa and South and Central America. Commercial linkages between the various parties have soared over the past decade, but from a low base. Africa has attracted the most attention and capital of India and China relative to Latin America. Resource-seeking investment has been a prime motivator of China and India, but their investment in both Africa and South and Central America extends well beyond energy/mining. Further deepening and integration is expected in the future, challenging the stakes of the United States and Europe.

In a major shift from the past, outward foreign direct investment has become an important economic dimension for both China and India. Indeed, in the past ten years, Chinese and Indian firms have become more globally-minded, with companies, motivated by market conditions and government policies, becoming more embedded in the global economy via foreign direct investment. Globally shy no more, China's outward FDI stock, totaling just $4.4 billion in 1990 (or 1.1% of GDP), spiked to $28 billion in 2000 before soaring to roughly $509 billion in 2012 (or greater than 6% of GDP). The surge reflects soaring annual FDI outflows, with outflows totaling $75 billion in 2011 and $84.2 billion in 2012; comparable levels in 2000 and 2001 were just $916 million and $6.9 billion, respectively.

Outward flows from India, while not as large as China's, have been just as robust given the lower starting point. Annual FDI outflows were less than $1 billion in 2000 but peaked at $21.1 billion in 2008, prior to the financial crisis. Outflows totaled roughly $8.6 billion in 2012, pushing India's outward FDI stock to $118.2 billion in 2012, over 6% of GDP and a 68-fold increase from the beginning of the century. The combined outward FDI stock of China and India was roughly 2.7% of the global total in 2012, up from 0.4% in 2000. As of 2012, China was the 14th largest outward investor in the world, while India ranked 27th.

As Chinese and Indian firms have burrowed deeper into Africa, policymakers in the developed nations have become increasingly concerned and alarmed by the spread of China's and India's global footprint, notably in regions of the world like Africa that have long been under the West's sphere of influence. As a pointed jab at China, Secretary of State Hillary Rodham Clinton warned in a June 2011 speech in Zambia of 'new colonialism" threatening the African continent.[11]

Despite these worries, what is driving both nations overseas are the same variables that have long influenced and spurred U.S. and European firms to invest abroad. To this point, resource-seeking Chinese energy firms are emulating the corporate

[11] Dambisa Moyo, "Beijing, A Boom For Africa," *The New York Times*, June 28, 2012, p. A27.

strategies of American and Japanese energy giants in the 1950s and 1960s. Where the difference lies, and where there are lingering potential areas of conflict with the United States and Europe, pivots around China's more government-led and more geo-strategic investment in Africa.

As part of China's "going out" strategy (*zou chuqu*), a key priority of Chinese foreign direct investment is securing strategic assets and natural resources to fuel the industrialization, motorization and urbanization of the Middle Kingdom. Thanks to these tectonic economic trends, China's demand for global commodities has been nothing short of stunning. The nation is now the second largest consumer of oil after the United States, and presently devours 25% of the world's soybeans, 20% of the world's corn and 16% of the world's wheat. The mainland also accounts for nearly 25% of world rubber consumption. Name the commodity and there is a good chance China is among the largest consumers in the world.[12]

China's secular rise in commodity demand, juxtaposed against a steady decline in arable land, mounting deforestation, rising water scarcity, and herculean environmental challenges at home makes the nation fanatically focused on food and energy security for its 1.4 billion population. Hence Beijing's unstinting support to state-owned Chinese firms investing overseas in commodity-rich Africa, a strategic target of China.

There is a direct link between China's resource-seeking FDI in Africa and the nation's energy security policies. Hence, a great deal of China FDI to Africa is bundled, and includes bilateral aid and grants, low cost loans and other preferential financing arrangements provided by China's so-called policy banks—all competitive metrics that could put U.S. and European firms at a competitive disadvantage in Africa and South and Central America for that matter.[13]

Government-led support for Chinese investment in Africa includes formal arrangements, with China launching the Forum on China-Africa Co-operation (FOCAC) in October 2000 to facilitate greater multilateral economic cooperation among key African states. This development is another way of saying that the Atlantic Basin will continue to have a strong Chinese influence. To this point, China's trade and investment with Africa has soared over the past few years. For instance, between 2000 and 2012, China's exports to Africa soared from just \$4.2 billion at the start of the century to nearly \$75 billion in 2012. South Africa, Nigeria and Egypt ranked as the three largest African export markets for China; South Africa alone accounted for nearly one-fifth of total exports.

Chinese imports from Africa, meanwhile, rose in comparable fashion. Imports tallied just \$5.4 billion in 2000 but exceeded \$105 billion in 2012; reflecting China's need for resources and China-related investment in Africa's energy infrastructure, the bulk of

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[12] World Bank. See also Christopher Alessi and Stephanie Hanson, "Expanding China-Africa Oil Ties," Council on Foreign Relations, February 8, 2012; Joseph P. Quinlan, "Growing Economic Linkages with Latin America and Africa: Key Drivers and Trends," in Emiliano Alessandri, et. al, *China and India: New Actors in the Southern Atlantic*. Washington, DC: German Marshall Fund of the United States, December 2012; Deborah Brautigam, "Africa's Eastern Promise: What the West Can Learn From Chinese Investment in Africa," *Foreign Affairs*, January 5, 2010; Keith Proctor, "China and Africa What the U.S. Doesn't Understand," CNN Money, July 2, 2013, http://management.fortune.cnn.com/2013/07/02/china-africa-us.

[13] Global Investment Monitor, "The Rise of BRICS FDI and Africa," UNCTAD, March 25, 2013.

[13] According to David Shinn, "The official FDI figure for China in Africa significantly understates the actual amount for a variety of reasons. 1. It only represents FDI that is officially reported to the government of China. Some private Chinese investors do not report FDI flows. China's official numbers miss FDI that passes through Hong Kong, the Cayman Islands and the British Virgin Islands and goes to many countries, including some in Africa. 2. Chinese FDI statistics do not include investment in the financial sector. For example, China's \$5.5 billion purchase of 20 % of Standard Bank of South Africa is presumably not reflected in the cumulative figures for FDI to Africa. 3. China has also made several large investments in companies located in countries outside Africa that have significant holdings in Africa. These investments would not appear in the cumulative figure for Africa." http://davidshinn.blogspot.com/2013/03/foreign-direct-investment-in-africa.html.

imports was comprised of oil and other commodities. Africa provides China with 30% of its tobacco, 25% of its pearls and precious metals, 20% of its crude oil and cocoa, 10% of its ores, and 5% of its iron and steel. Surging trade flows reflect in large part the widening presence of Chinese FDI in Africa, with the stock of outward Chinese FDI to Africa soaring from $491 million in 2003 to over $21.7 billion in 2012, more than a twenty-five fold increase.

Meanwhile, Indian FDI outflows to Africa totaled $9.3 billion over 2002-09 versus just $750 million over 1996-02. Of the $9.3 billion total, roughly two-thirds was invested in Mauritius, a critical offshore financial center for Indian firms. Bilateral trade between India and Africa has increased dramatically over the past decade as well. Indian exports to Africa rose more than 13-fold between 2000 ($1.9 billion) and 2012 ($25 billion). Imports from Africa illustrated a similar trend, surging from $3.1 billion in 2000 to roughly $38 billion in 2012. India posted a trade deficit of $13.1 billion with Africa in 2012; China's deficit was larger -- $30.8 billion.

Like Africa, Latin America has become more important to both China and India over the past decade as both as a source of raw materials and a new market for manufactured goods. China's soaring energy and agricultural needs account for China's rising investment profile in Brazil, Peru and Venezuela, the top destinations for Chinese foreign direct investment excluding the mainland's investment in the offshore centers of the Cayman Islands and the British Virgin Islands.

Latin America has been at the receiving end of many large Chinese loans to help finance natural resource-based deals and infrastructure spending. To this point, the Inter-American Dialogue notes that China loan commitments of $37 billion in 2010 were more than those from the World Bank, Inter-American Development Bank and U.S. Export-Import Bank combined.

Against this backdrop, heavy financing from Chinese banks have underwritten rising trade and investment flows between China and Latin America. In particular, the last decade has seen sharp spikes in Chinese investment in Brazil, with China's FDI stock rising from just $52 million in 2003 to $1.1 billion in 2011, Peru (from $126 million in 2003 to $802 million in 2011) and Venezuela, where China's FDI stock soared from just $19.4 million in 2003 to $802 million in 2011. As a large investor in Panama's transportation sector, Chinese FDI stock in the strategically-important nation totaled $331 million, larger than China's investment position in Mexico ($264 million).

Clearly, Chinese investment flows are ramping up, with China's investment in Latin America totaling nearly $12 billion in 2011—the largest annual increase on record, with Brazil accounting for half of the total. Indian investment has lagged behind but is expected to accelerate in the coming decade as India seeks to tap into Latin America's abundant fresh water supplies and agricultural/energy resources.

4. Foreign Investment in the Atlantic Basin - A Closer Look

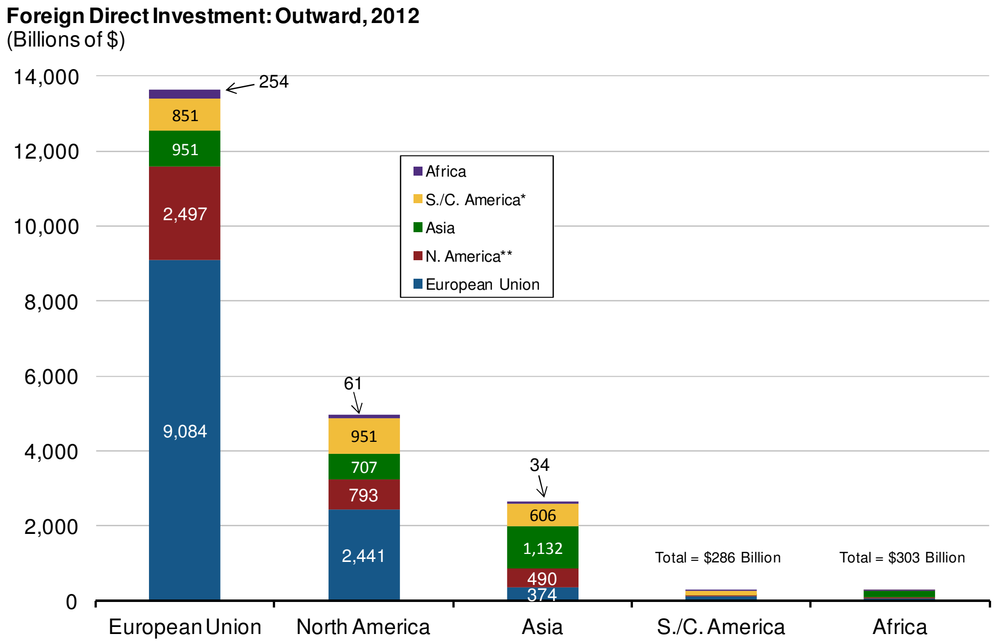
It is the dynamic interaction between investment and trade that distinguishes the pan-Atlantic economy from all others. Foreign investment and affiliate sales power pan-Atlantic commerce and provide millions of jobs. Affiliate sales on either side of the Atlantic are more than double comparable sales in the entire Asia/Pacific.

The foreign investment picture differs for each Atlantic continent. Europe is the world's most dynamic region for FDI. The EU is the largest provider and recipient of FDI among all world regions. FDI flows have significantly deepened Europe's linkages with the rest of the world.

4.1 Patterns of Outward FDI

Despite Europe's important role as global investor, European companies invest mainly within the EU itself, underscoring the importance and attractiveness of the Single Market. In 2012 European companies invested 3.6 times as much in the EU as they did in North America and twice what they invested in the rest of the world overall. Nonetheless, EU investment in North America is substantial; at $2.437 trillion in 2012 it was about 2.6 times greater than European investment in all of Asia, 2.9 times EU investment in South and Central America and almost 10 times more than EU investment in Africa.

Figure 18. Foreign Direct Investment Outward, 2012



*Includes Caribbean.
**U.S., Canada, Mexico.
Source: International Monetary Fund: *Coordinated Direct Investment Survey.*

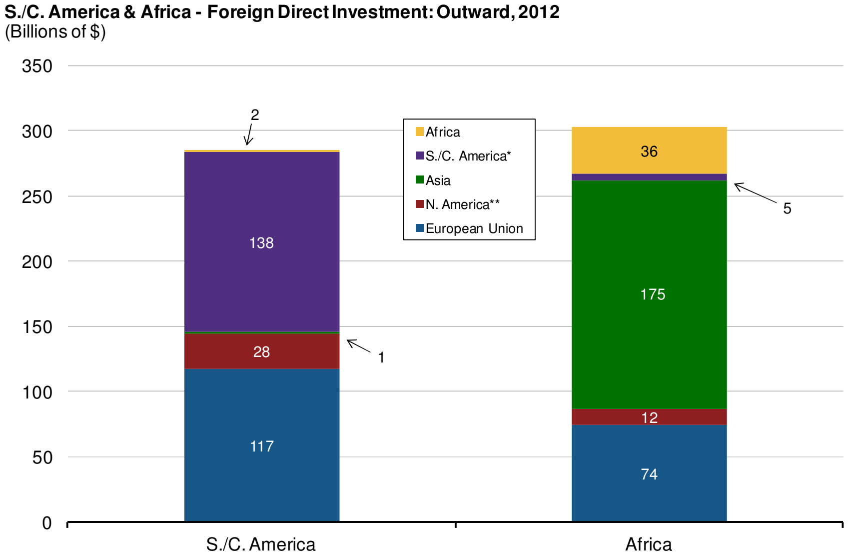
EU foreign direct investment in South and Central America is also considerable, totaling $851 billion in 2012, somewhat less than than EU foreign direct investment in all of Asia. EU foreign direct investment in the four continents of the Atlantic Hemisphere was 3.8 times EU FDI in Asia.

North American FDI, in contrast, is directed more to the EU than to North American itself. In 2012 North American FDI in the EU was 3 times greater than North American cross-border FDI in NAFTA. North American FDI was even greater in South and Central America than in NAFTA.

North American FDI in the EU in 2012 was 3.5 times North American FDI in all of Asia and 2.6 times North American FDI in South and Central America; if non-EU countries are included the discrepancies were even higher. North American FDI in South and Central America, in turn, was greater than North American FDI in all of Asia. In total, North American FDI in the Atlantic Hemisphere was 6 times higher than North American FDI in Asia.

Most Asian FDI flows within Asia than to any individual Atlantic continent, but there is greater Asian FDI in the Atlantic Hemisphere than in the Asian Hemisphere. This reflects Asian companies seeking resources in South and Central America and Africa, and profiting from open investment regimes in North Atlantic countries. In 2012 Asian FDI in South and Central America was 18 times greater than Asian FDI in Africa. In fact, more Asian FDI flowed to South and Central America than to North America or to Europe. This reflects in part investments related to off-shore money centers in the Caribbean. Those figures are particularly noticeable when it comes to portfolio assets, but there is spillover to FDI as well.

Figure 19. South and Central America and Africa -- Foreign Direct Investment Outward, 2012



*Includes Caribbean.
**U.S., Canada, Mexico.
Source: International Monetary Fund: *Coordinated Direct Investment Survey.*

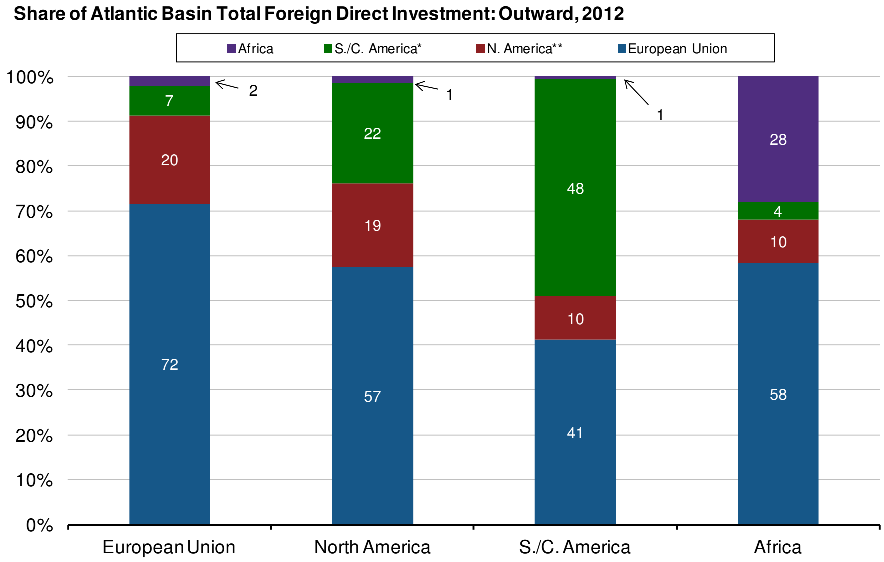
Outward FDI from South and Central America and Africa in 2012 was minimal in comparison to FDI from North America, Europe or Asia. African outward FDI exceeded South and Central American outward FDI. Fifty-nine percent of African outward FDI went to Asia, and 25 percent went to Europe in 2012 -- double the amount of African FDI that went to other African destinations. A plurality of outward FDI from South and Central American sources, in contrast, stayed within the region itself, with most of the rest flowing to Atlantic destinations. Asia attracted a relatively meager $1 billion in FDI from South and Central America in 2012, half the amount that flowed from South and Central America to Africa.

EU FDI in South and Central America of $537 billion in 2012 was 2.5 times North American FDI in the region of $230 billion, 8.5 times greater than Asian FDI flows to South and Central America and about 3.4 times greater than South and Central American FDI flows within the region itself.

EU FDI in Africa was almost 4.5 times greater than North American FDI and double Asian FDI in Africa in 2012. Asian FDI was 2.3 times North American FDI in Africa.

South and Central American FDI in Africa is approaching the levels invested by North America in Africa.

Figure 20. Share of Atlantic Basin Total Foreign Direct Investment Outward 2012



*Includes Caribbean.
**U.S., Canada, Mexico.
Source: International Monetary Fund: *Coordinated Direct Investment Survey*.

Within the Atlantic Hemisphere, EU companies invested 72 percent within the EU itself in 2012. Fifty-seven percent of North American FDI within the Atlantic Hemisphere, in contrast, flowed to the EU, and 22 percent to South and Central America, compared to just 19 percent within NAFTA itself, and only 2 percent to Africa. Forty-eight percent of South and Central American FDI within the Atlantic Hemisphere stayed within the region itself, followed closely by flows to the EU; only 10 percent flowed to North America and only 1 percent to Africa. Fifty-eight percent of African FDI within the Atlantic Hemisphere flowed to the EU, more than double African FDI within Africa itself. North America accounted for 10 percent and South and Central America for only 4 percent of African FDI within the Atlantic Hemisphere.

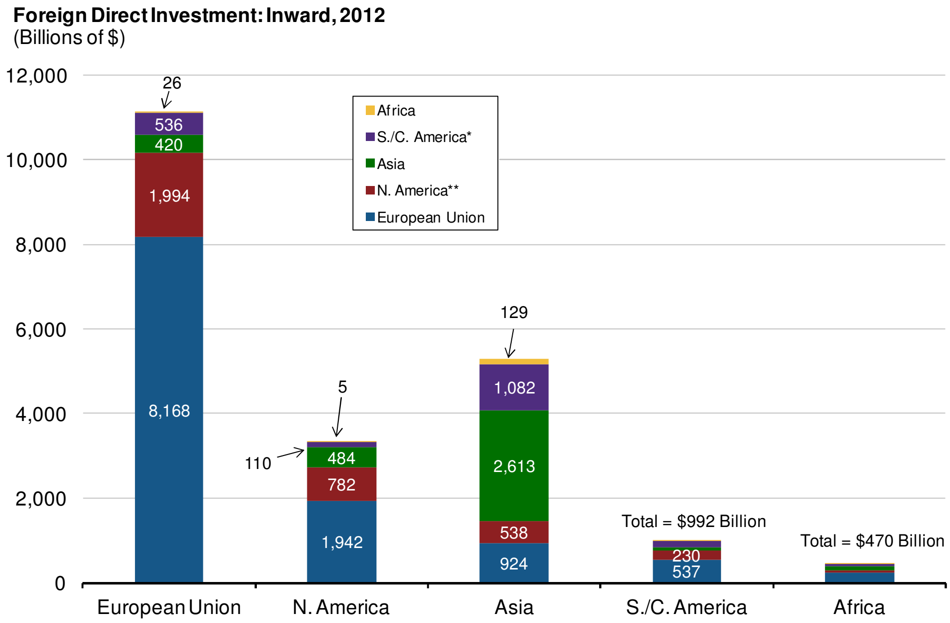
4.2 Patterns of Inward FDI

Most FDI in the EU comes from European companies themselves. Inner-EU FDI in 2012 was four times the level of North American investment in the EU. Yet North American FDI of $2 trillion was about 2.3 times more than South and Central American FDI in the EU and almost 5 times the level of Asian FDI in the EU.

The United States is by far the most important source country of foreign direct investment in the European Union. Despite the rise of other markets, Europe continues to account for 56% of U.S. foreign direct investment worldwide. U.S. investment in Europe is nearly four times larger than U.S. investment in all of Asia and 13 times more than U.S. investment in the BRICs. Between 2000 and 2012 China accounted for only about 1% of total global U.S. investment, less than tiny Belgium. U.S. investment in the Netherlands during this period was more than 14 times larger than in China. And in 2011 and 2012 U.S. companies have actually disinvested $6.5 billion from China while investing $428 billion in Europe. U.S. affiliate income from China and India together in 2011 ($13.1 billion) was less than half U.S. affiliate earnings in Ireland ($29 billion).

Announcements in 2010 of new investments by Chinese companies in Greece attracted considerable attention and anticipation of surging Chinese investments in Europe. Such investments can of course be important for Greek ports and shipping, but overall the volume of Chinese investment in Europe is quite low.[14] In fact, for all the talk of Asian investment in Europe, total Asian FDI in the EU in 2012 was significantly less than South and Central American FDI in the EU. FDI from non-EU Atlantic Hemisphere sources in 2012 were 6 times Asian FDI in the EU.

Figure 21. Foreign Direct Investment Inward 2012



*Includes Caribbean.
**U.S., Canada, Mexico.
Source: International Monetary Fund: *Coordinated Direct Investment Survey.*

The EU is the largest source of FDI in North America; EU FDI in North America in 2012 was about 2.5 times North American FDI within the region itself and 4 times the level of Asian FDI in North America. EU investment in the United States accounts for 74% of total foreign direct investment in the U.S. and is 27 times the level of EU investment in China and more than 55 times the level of EU investment in India. In fact, there is more European investment in a single U.S. state such as Indiana or Georgia than all U.S. investment in China, Japan and India combined.

Most FDI within Asia comes from Asian countries themselves. The second largest source of FDI in Asia, however, is South and Central America, which in 2012 accounted for 41% of inner-Asian FDI in Asia, more than EU FDI in Asia and double North American FDI in Asia. This is largely due to flows from Caribbean money centers and is most likely Asian investments that are repatriated back to Asia.

A variety of factors limit North American and European FDI in Asia. Many negative considerations dampening such flows are specific to individual countries. For example, inefficient bureaucracy and a poorly developed infrastructure figure among the most important barriers for FDI in India. In China, investor concerns about property rights,

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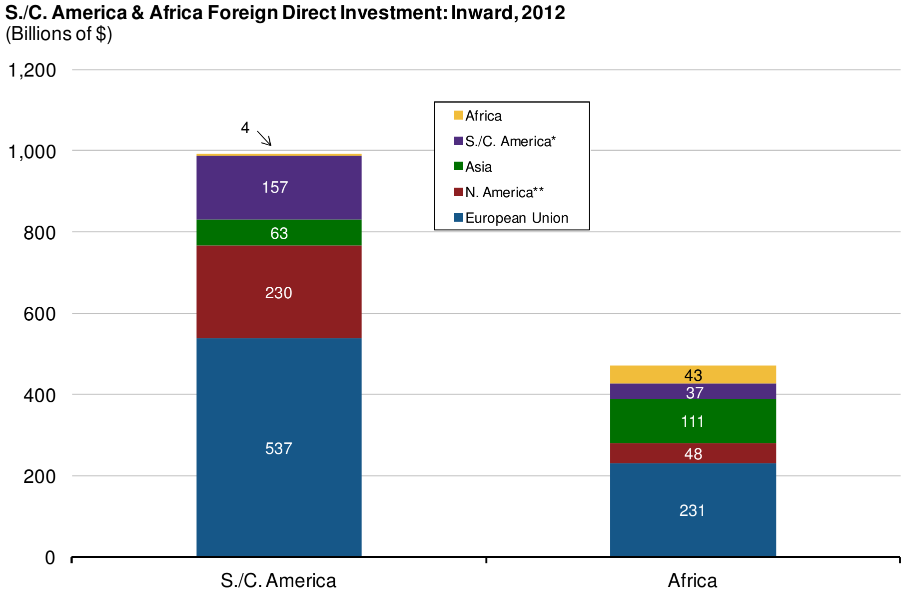
[14] European Competitiveness Report 2009.

intellectual property and remaining restrictions and caps on foreign ownership in the service sectors limit EU and North American investment.[15]

Figure 22. South and Central America and Africa Foreign Direct Investment Inward, 2012

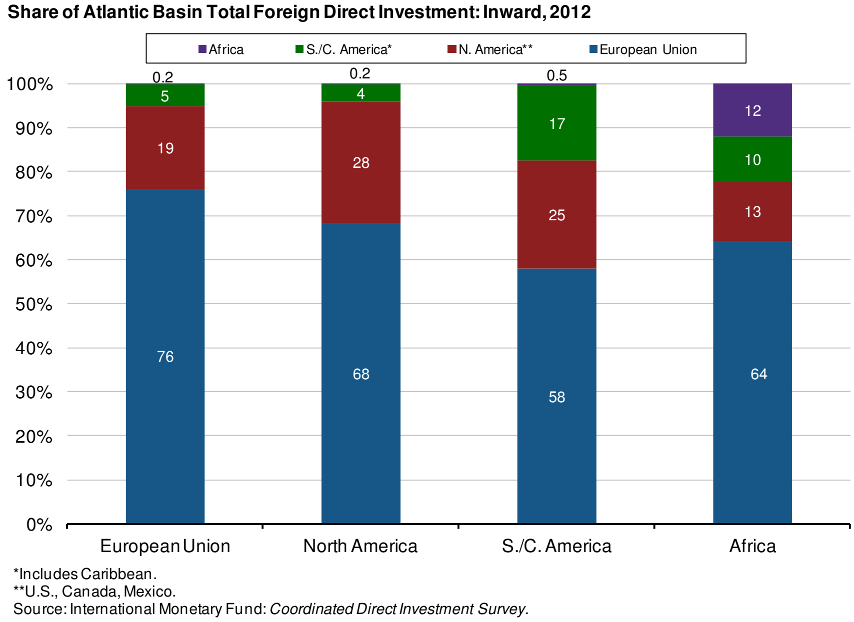


*Includes Caribbean.
**U.S., Canada, Mexico.
Source: International Monetary Fund: *Coordinated Direct Investment Survey*.

The EU is the largest source of FDI in South and Central America, accounting for 2.3 times the level of North American investment in the region in 2012. The eurozone accounts for 40 percent of all FDI in Latin America, the EU is the biggest foreign investor in Brazil, and São Paulo hosts the largest concentration of German corporate investment outside Germany. Since 2000, U.S. and European firms have each invested significantly more capital in Brazil than in China. Both EU and North American FDI in the region is greater than intra-regional FDI, which in 2012 accounted for only 29 percent of EU FDI and 68 percent of North American FDI in the region.

[15] M. Frenkel, K. Funke and G. Stadtmann A Panel Analysis of Bilateral FDI Flows to Emerging Economies, Economic Systems, Vol. 28, (2004), pp. 281-300; Gábor Hunya, "Austrian FDI by Main Countries and Industries," FIW Study No. 015 (2008); Hunya and Stöllinger, op. cit.; D. Bartlett, "Economic Trends in the BRIC Countries," April 7, 2008, http://www.thefinancedirector.com/features/feature1710/.

Figure 23. Share of Atlantic Basin Total Foreign Direct Investment Inward 2012



The EU is the largest source of FDI in Africa, accounting for twice Asian FDI in Africa and 5 times more than North American FDI in Africa in 2012. The EU, Asia and North America all invested more in Africa than African companies invested in Africa.

FDI ties between South and Central America and Africa are weak. South and Central America invested $37 billion in Africa in 2012, and Africa invested only $2 billion in South and Central America.

5. Portfolio Investments[16]

In 1900, private capital flows could be measured in the hundreds of millions of dollars, and involved relatively few countries.[17] Today, they are measured in the hundreds of billions of dollars, and many, many countries are involved. Money is traded around the clock, with more and more of the world's financial markets electronically connected and linked.

Most investment during those early days of globalization was limited largely to portfolio investment in railroads, municipal and national bonds, and a few other types of assets in the newly emerging markets of the time. Lending focused on governmental authorities. Foreign direct investment played a smaller role, and production processes were not as highly integrated as they are now. In recent decades, however, the breadth and depth of international capital investments grew rapidly. Firms used their investments to form alliances and extend value chains internationally in very complex

[16] Portfolio investment includes equity securities such as shares, stocks, and mutual funds; and debt securities such as bonds, Treasury bills and commercial and finance paper.

[17] For an overview of capital flows then and now, see Lund and Roxburgh, op. cit.; Michael Bordo, "Globalization in Historical Perspective," *Business Economics*, January 2002; Kevin H. O'Rourke and Jeffrey G. Williamson, *Globalization and History: The Evolution of a Nineteenth-Century Atlantic Economy* (Cambridge, MA: MIT Press, 1999); Michael D. Bordo, Barry Eichengreen and Douglas A. Irwin, "Is Globalization Today Really Different from Globalization a Hundred Years Ago?" in Susan M. Collins and Robert Z. Lawrence, *Brookings Trade Forum 1999* (Washington, DC: Brookings Institution Press, 1999)

networks. Industry, finance, and the services sector in emerging markets became important candidates for foreign portfolio investments.

The result was a significant boost in capital flows around the world. From 1980 through 2007, the world's financial assets—including equities, private and public debt, and bank deposits—nearly quadrupled in size relative to global GDP. Global capital flows similarly surged. Between 1990 and 2006, cross-border capital flows grew more than 10% annually. Over this period, capital flows to emerging markets grew twice as fast as inflows to developed countries.[18] In the wake of the Great Recession, as the EU, the U.S. and Japan record low growth and struggle with debt and challenges to their still-fragile financial systems, the flow of capital to emerging markets has accelerated, prompting some capitals to adopt controls on the inflow.

Daily turnover in the foreign exchange markets totaled $3.2 trillion on the eve of the recession in early 2007, an increase of over 70% from 2004 and nearly four times that of two decades earlier. The dollar and the euro were at the cutting edge of this trend, accounting for most daily global turnover. The velocity of capital also spawned more of a global equity culture, evident by the fact that at the end of 2006, the world's stock market capitalization represented 99.2% of world output, up from a 36.2% share in 1990.

At the same time, however, credit bubbles grew both in the United States and Europe. Contrary to popular perceptions, credit in Europe grew larger as a percent of GDP than in the United States. Total U.S. credit outstanding rose from 221% of GDP in 2000 to 291% in 2008, reaching $42 trillion. Eurozone indebtedness rose even higher, to 304% of GDP by the end of 2008, while UK borrowing climbed even higher, to 320%.[19]

Finally, the bubble burst. The global economic crisis was triggered by the deteriorating quality of U.S. subprime mortgages -- housing loans offered to homebuyers at below prime rates. Although this device was invented and offered widely in the United States, these mortgages were packaged or securitized, then given top-rate credit ratings, and sold all over the world. Many European banks and investors snapped up these mortgage-related instruments, such as collateralized debt obligations, credit default swaps and structured investment vehicles (SIVs). In addition, many European banks were eager lenders to construction firms and households, given low global interest rates and abundant levels of global capital. When falling home prices and a series of defaults turned into a major subprime meltdown in the U.S. in 2007, Europe was also engulfed in a global credit crisis.

The global financial crisis and worldwide recession abruptly halted nearly three decades of expansion for international capital markets. It has raised widespread concerns about the volatility of capital flows and generated a greater sense of vulnerability among stakeholders to such flows. The total value of the world's financial assets fell by $16 trillion in 2008, to $178 trillion, the largest setback on record.[20] Declines in equity and real estate wiped out $28.8 trillion of global wealth in 2008 and the first half of 2009. Cross-border capital flows[21] fell 82% from $10.5 trillion in 2007 to just $1.9 trillion in 2008. Relative to GDP, the 2008 level of cross-border capital flows was the lowest since 1991. Cross-border lending fell from $4.9 trillion in 2007 to minus $1.3 trillion in 2008, meaning that lenders cancelled more cross-border loans than they made. In the worst-hit countries, foreign bank credit contracted by as much as 67%.

[18] Much of this section is drawn from Lund and Roxburgh, op.cit.
[19] Lund and Roxburgh, op. cit.
[20] By 2007, the total value of global financial assets reached a peak of $194 trillion, equal to 343% of GDP. See Hamilton and Quinlan, *The Transatlantic Economy 2010*, op. cit.
[21] This includes foreign direct investment (FDI), purchases and sales of foreign equities and debt securities, and cross-border lending and deposits.

Flows of foreign deposits also reversed course, as investors withdrew $400 billion of deposits from foreign financial centers in 2008.[22]

Across world regions, the UK and the eurozone experienced the largest declines in cross-border capital flows. In 2008 foreign investors withdrew more money from the UK than they put in. The fall-off in capital flows in western Europe— equivalent to 21% of collective GDP—reflected the reversal of lending flows between the UK and the eurozone, a decline in flows between individual eurozone countries, and the plunge of flows between European countries and the United States.

The financial crisis and attendant recession has had a powerful impact especially among North Atlantic countries. Financial markets in Europe and North America have been stagnant or grown slowly while fiscal deficits have cause government debt to soar. Capital flows are slowly reviving and developing new patterns.[23] Many emerging markets have suffered as well, while others have advanced. Yet overall developing nations—despite having over $10 trillion at their disposal in the form of international reserves—have failed to effectively use their financial firepower to stave off a cyclical economic slowdown, let alone marshal their massive savings to fundamentally remake the global financial order. Fears that the U.S. Federal Reserve would "taper," or gradually remove, excess liquidity from the U.S. capital markets, sparked a firestorm in the emerging markets in 2013, prompting massive capital outflows in many developing nations and attendant macroeconomic problems for nations like South Africa, Brazil, Russia, Turkey and many others. These trends were a strong reminder that the developed nations still largely dictate and influence global capital flows, and remain at the center of the global financial universe.

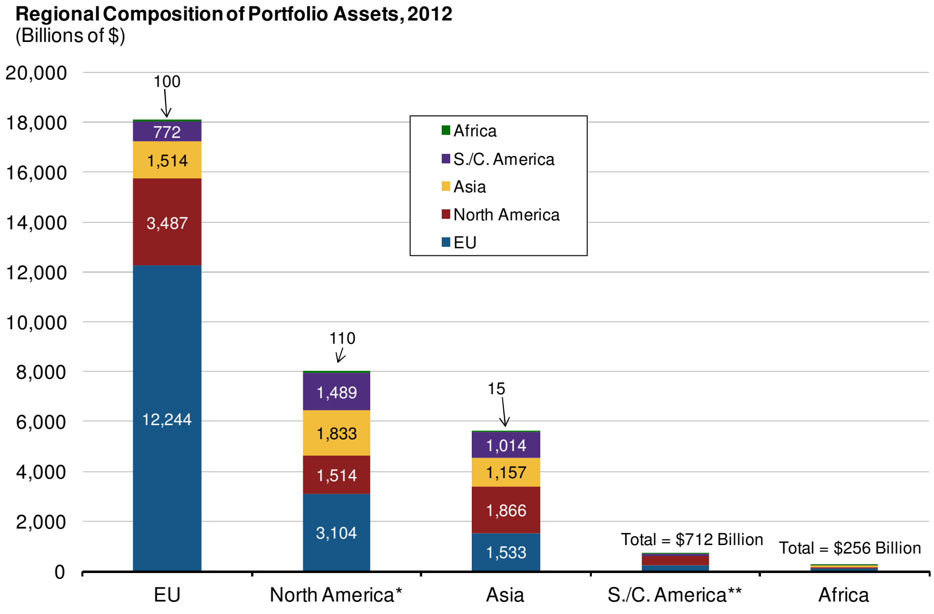
Nonetheless beyond the headlines the global financial architecture is being reconfigured, and various crosscurrents are at work. Overall, for investors and financial intermediaries alike, emerging markets will become more important as their share of global capital markets continues to expand.[24] The question for this chapter is how such shifting patterns may play out across the Atlantic Basin. A number of charts can illuminate the current nature of and relationships among portfolio assets.

[22] Lund and Roxburgh, op. cit.

[23] According to the McKinsey Global Institute, "2008 may have marked an inflection point in the growth trajectory of financial markets in North America, Europe, and Japan. Financial assets in those regions more than tripled from 1990 through 2007, to $158 trillion, or 403 percent of GDP. But the circumstances that fueled the rapid increases of past years, particularly in equities and private debt, have changed, making it likely that total financial assets will grow more in line with GDP in coming years." Ibid.

[24] Ibid.

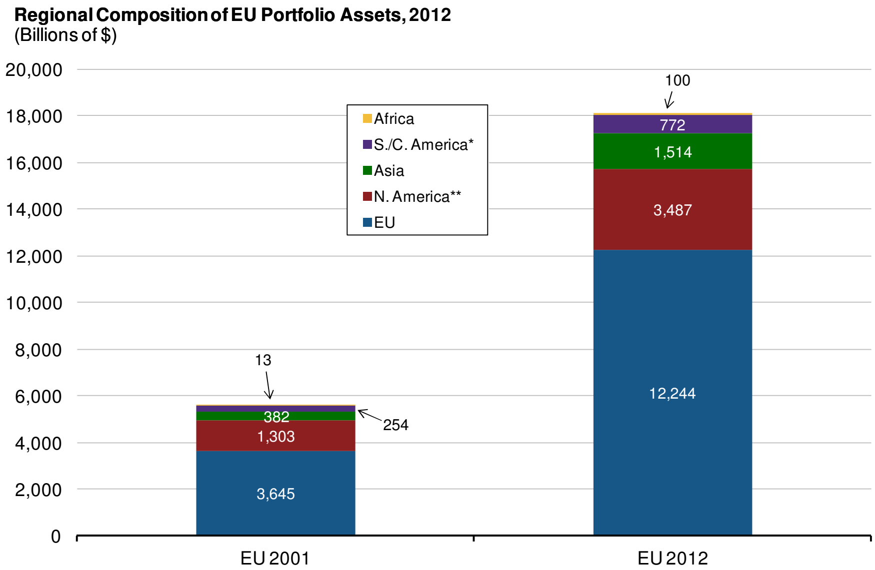
Figure 24. Regional Composition of Portfolio Assets, 2012



*U.S., Canada, and Mexico
**Includes Caribbean
Source: International Monetary Fund: *Coordinated Portfolio Investment Survey*

Figure 24 indicates that in 2012 total portfolio assets in the EU were significantly more than those in North America and in Asia. The EU was the largest holder of portfolio assets in North America, while North America was the largest holder of portfolio assets in Asia.

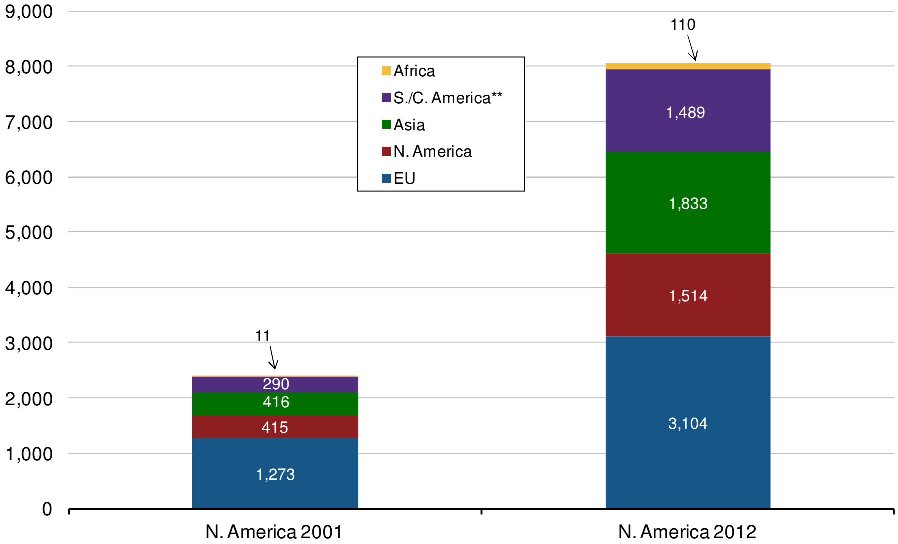
Figure 25. Regional Composition of EU Portfolio Assets, 2012



*Includes Caribbean
**U.S., Canada, and Mexico
Source: International Monetary Fund: *Coordinated Portfolio Investment Survey*

Portfolio assets in the EU grew from $5.597 trillion in 2001 to $18.117 trillion in 2012. EU portfolio holders account for about two-thirds of those assets. North America accounted for $3.487 trillion and Asia for $1.514 trillion; South and Central American and African portfolio assets in the EU grew rapidly from 2001, but each from a low base.

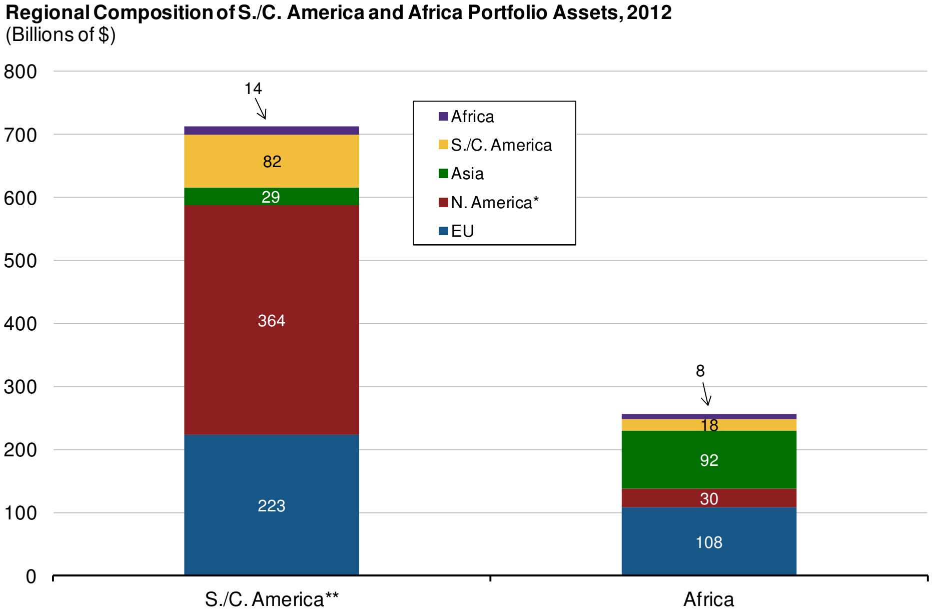
Figure 26. Regional Composition of North America Portfolio Assets, 2012



*U.S., Canada, and Mexico
**Includes Caribbean
Source: International Monetary Fund: *Coordinated Portfolio Investment Survey*

Portfolio assets in North America grew from $2.405 trillion in 2001 to $8.050 trillion in 2012. The EU held triple the value of North American portfolio assets than North Americans held of each other's assets in 2001, and about double in 2012. Asia's share was roughly equal to North America's own share in 2001; by 2012 Asia's share had grown relative to North America's share. South and Central American portfolio assets in North America grew rapidly from 2001 to roughly equal North American cross-border portfolio assets in North America. Africa's assets in North America grew rapidly over this period, but from a low base.

Figure 27. Regional Composition of South/Central America and Africa Portfolio Assets, 2012



*U.S., Canada, and Mexico
**Includes Caribbean
Source: International Monetary Fund: *Coordinated Portfolio Investment Survey*

North America increased its portfolio holdings in South and Central America four-fold between 2001 and 2011, accounting for over half of the region's assets. The EU was the only other major asset holder. The region's own holdings are modest, and both Asia and Africa are non-players.

In contrast, Asia and the EU were roughly equal as portfolio asset holders in Africa, each accounting for roughly 3 times greater assets than North America held in Africa. The trend is also quite striking. Whereas in 2001 Asian portfolio assets in Africa were practically non-existent, they have risen dramatically. EU portfolio assets in Africa also rose 4 times in this period, but in 2001 the EU accounted for the vast majority of African portfolio assets, now its share is roughly equal to that of Asia. South and Central American portfolio assets in Africa have also grown to about half of North American assets held in Africa

Between 2001 and 2012 the EU's share of total portfolio assets in Africa fell from 71.8% to 40.7%, and North America's share fell from 15.8% to 11.4%. The Atlantic Hemisphere's share overall in Africa fell from 88.7 percent in 2001 to 61.8 percent in 2012, reflecting the ascendancy of Asia in Africa.

In South and Central America North America's share of total portfolio assets fell from 68.3% to 48.4% , while the EU's share rose from 12.8% to 29.7%. South and Central American holdings also declined from a 13.7% share in 2001 to a 10.9% share in 2012. Africa remained a non-player; Asia's investment share was also marginal.

In the EU the region's own share of portfolio assets remained high and steady at 61.8% in 2012, whereas North America's share fell from 21.6% in 2001 to 17.6% in 2012, although the Atlantic Hemisphere's share of EU portfolio assets remained high at 83.8%.

Figure 28. Portfolio Investment, Total Assets, 2001/2012

Portfolio Investment, Total Assets, 2012

Investment From (Billions of $)...

	EU		North America		Asia		South/Central America		Africa	
Investment In...	$	% Total	$	% Total	$	% Total	$	% Total	$	% Total
EU	12,244	61.8%	3,104	35.1%	1,533	24.8%	223.0	29.7%	108	40.7%
North America*	3,487	17.6%	1,514	17.1%	1,866	30.2%	364	48.4%	30	11.4%
Asia	1,514	7.6%	1,833	20.7%	1,157	18.7%	29	3.9%	92	34.9%
South/Central America**	772	3.9%	1,489	16.8%	1,014	16.4%	82	10.9%	18	6.7%
Africa	100	0.5%	110	1.2%	15	0.3%	14	1.9%	8	2.9%
World Total	19,823	91.4%	8,841	91.1%	6,179	90.4%	752	94.8%	264	96.7%

Portfolio Investment, Total Assets, 2001

Investment From (Billions of $)...

	EU		North America		Asia		South/Central America		Africa	
Investment In...	$	% Total	$	% Total	$	% Total	$	% Total	$	% Total
EU	3,645	60.6%	1,273	49.6%	614	35.7%	36.2	12.8%	23	71.8%
North America*	1,303	21.6%	415	16.2%	642	37.4%	193	68.3%	5	15.8%
Asia	382	6.3%	416	16.2%	152	8.9%	9	3.1%	1	3.1%
South/Central America**	254	4.2%	290	11.3%	210	12.2%	39	13.7%	0.3	0.9%
Africa	13	0.2%	11	0.4%	2	0.1%	2	0.7%	0.1	0.2%
World Total	6,019	93.0%	2,565	93.8%	1,719	94.3%	283	98.5%	32	91.8%

In North America, in contrast, the Atlantic Hemisphere's share fell from 77.5% in 2001 to 70.2% in 2012. The EU's share fell from 49.6% in 2001 to 35.1% in 2012, while South and Central America's share rose from 11.3% in 2001 to 16.8% in 2012. Asia's share also increased from 16.2% to 20.7%.