Policy Measures to Attract FDI: An Overview of International Experience and Recommendations for Belarus

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Executive Summary
Over the last two decades global competition for FDI has sharpened considerably. Improving foreign direct attractiveness and making the most of locational advantages is a challenging task for national governments that calls for the design and implementation of sophisticated and comprehensive policy measures.

This paper examines FDI policies in China, India, Korea, Brazil, Slovakia and Poland; countries that achieved most impressive results in FDI attraction and foreign capital utilization. Analysis of these countries’ experiences reveals that provision of incentives (e.g. tax exemption or reduction, financial subsidies, reduced import tariffs and etc.) coupled with the implementation of macroeconomic policies that help foreign investors to conduct business without incurring unnecessary risk and there are the key factors in creating a favourable environment for FDI. The success of these countries in foreign capital attraction can also be explained by the fact that their FDI policies are integral parts of their industrial and development policies.

To improve the investment climate the Belarusian Government should ensure a stable macroeconomic environment, speed up privatization, improve the business environment and increase its predictability, and take measures to combat bureaucracy and corruption. Furthermore, there should be a consistent match between the FDI attraction policy and industrial policy. FDI incentives should be elaborated based on the Belarusian Government’s vision of the future industrial landscape, and with this principle in mind investors should be carefully targeted based on sector prospects and investment motives, as investors’ priorities depend on the sector in which they are going to invest. In addition effective aftercare services that address problems that investors are facing can help foreign companies and make Belarus more attractive for FDI. Such incentives as investment grants (employment, R&D, training and etc) can encourage greenfield FDI or investment in regions (outside Minsk or oblast cities)

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1. Introduction
Attracting foreign direct investment (FDI) has become an increasingly important factor in promoting growth, upgrading the competitiveness of the national economy and increasing its integration into global production. FDI inflow can enhance enterprise and human capital development, generate new jobs, bring in new technologies and stimulate technology spillovers in the recipient economies. Therefore over the last two decades global competition for FDI has sharpened considerably. Improving the foreign direct attractiveness of countries and making the most of their locational advantages is a challenging task for national governments that calls for the elaboration of sophisticated and comprehensive policy measures.

The paper aims to identify and examine FDI policies in selected countries (China, India, Korea, Brazil, Slovakia and Poland) in order to illustrate successful experiences. Belarus has undertaken several measures to attract FDI, however despite these efforts the country still is lagging behind the most transition economies in the region. As economies differ considerably in economic, political and cultural aspects and therefore in FDI policies and strategies, the main purpose of the study is to outline those aspects and considerations which are relevant to Belarusian economy in the promotion and attraction of FDI. Spectacular success in attracting FDI is the criteria used to select the countries for the comparative study. Special attention will be given to the channels of transmission of the current financial crises to FDI, assessment of its impact by types of FDI and possible policy implications. The paper is organized as follows: first it reviews the economic determinants of FDI. Part 3 examines the concrete experience of FDI attraction in selected countries. Part 4 analyses the impact of the economic and financial crisis on FDI attraction. The concluding section summarizes the major arguments and offers some policy recommendations for promoting FDI in Belarus.

2. Types of FDI and its determining factors
The most comprehensive explanations of the reasons for cross-border investments was developed by John Dunning who argues that firms invest abroad if they obtain locational advantages arising from direct access to markets, raw materials and lower unit labor costs, reduced transportation and communication costs, and avoidance of tariffs and nontariff barriers. Based on that logic he identifies four basic motives for FDI: (a) resource-seeking enterprises want to acquire access to natural or specific resources, skilled or semi-skilled labour and technological capability at a cost lower than in home country; (b) market-seeking firms are interested in access to internal and export markets for their goods and services; (c) efficiency seekers wish to exploit economies of scale and gain from cost and quality of human and physical infrastructure resources; and (d) strategic asset-seeking enterprises are keen to acquire the assets of foreign corporations to promote their long-term strategic objectives and increase international competitiveness.

Attractiveness for foreign direct investment to a large extent depends on host country determinants that summarized in Table 1. Not all determinants are equally suited for different categories of FDI; each type of investment has its own priority determinants and requires specific attraction strategies. However, recent surveys show that macro-economic stability, land ownership, a clear privatization procedure, transparent, predictable, consistent and sufficiently liberal laws and regulations, skills development, human capital investment and well-developed infrastructure have the most influence on foreign direct investment decision-making. At the same time recent studies show that high real average wages have a negative impact on FDI flows, although labor quality is also found to be very important.

Special consideration should be given to the effects of tax incentives for FDI flows. Inasmuch as investors compare tax burdens in different locations, such incentives are regarded by host countries as a way of drawing investors’ attention, and tax competition has increased as a result. In response to these competitive pressures governments usually reduce the corporate

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1 For details of recent trends in FDI in Belarus see PP/07/08 Impact of FDI on Trade and Technology Transfer in Belarus: Empirical Evidence and Policy Implications by Kolesnikova, I., Tochitskaya, I.
3 Measures of labour quality include the share of research engineers, scientists and technicians in total employees, the share of population with primary, junior secondary, and senior secondary school education, and overall labor productivity.
income tax rate. There is a wide range of estimates of the sensitivity of FDI to the tax burden. Studies examining cross-border flows suggest that on average, FDI decreases by 3.7% following a 1 percentage point increase in the tax rate. But depending on the industry and country being examined, or the time periods considered, the decrease may be in the range of 0% to 5%. Some recent studies find that FDI is becoming increasingly sensitive to taxation, reflecting the increasing mobility of capital as non-tax barriers to FDI are removed. Such estimates may be used to evaluate the long-run impact on FDI of corporate tax reform. It should be mentioned that some countries provide temporary tax relief to certain sectors or activities instead of lowering general tax rates.

Table 1: Host country determinants of FDI

<table>
<thead>
<tr>
<th>Economic conditions</th>
<th>Markets</th>
<th>Size; income levels; urbanization; stability and growth prospects; access to regional markets; distribution and demand patterns.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Resources</td>
<td></td>
<td>Labour availability, cost, skills, trainability; managerial technical skills; access to inputs; physical infrastructure; supplier base; technology support.</td>
</tr>
<tr>
<td>Competitiveness</td>
<td></td>
<td>Management of crucial macro variables; ease of remittance; access to foreign exchange.</td>
</tr>
<tr>
<td>Host country policies</td>
<td></td>
<td>Trade strategy; regional integration and access to markets; ownership controls; competition policies; support for SMEs.</td>
</tr>
<tr>
<td>Private sector</td>
<td></td>
<td>Promotion of private ownership; clear and stable policies; easy entry/exit policies; efficient financial markets; other support.</td>
</tr>
<tr>
<td>Trade and industry</td>
<td></td>
<td>Trade strategy; regional integration and access to markets; ownership controls; competition policies; support for SMEs.</td>
</tr>
<tr>
<td>FDI policies</td>
<td></td>
<td>Ease of entry; ownership, incentives; access to inputs; transparent and stable policies.</td>
</tr>
<tr>
<td>Foreign investors strategies</td>
<td>Risk perception</td>
<td>Perceptions of country risk, based on political factors, macro management, labour markets, policy stability.</td>
</tr>
<tr>
<td>Location, sourcing, integration transfer.</td>
<td></td>
<td>Company strategies on location, sourcing of products/inputs, integration of affiliates, strategic alliances, training, technology</td>
</tr>
</tbody>
</table>


However, despite the fact that taxation is an important factor it is not the main determinant in investor’s decision-making that is influenced to a greater extent by long-term profitability. The importance of other taxes such as payroll and non-profit-related business taxes, as well as the friendliness of the tax administration, as well as the certainty, predictability, and consistency of tax rules should not be underestimated, as these factors can encourage investments quite as much as corporate income tax. Furthermore, recent analysis supports the view that a low tax burden cannot offset a generally weak or unattractive FDI environment. Where a higher corporate tax burden is matched by well-developed infrastructure, public services and other host country attributes that are attractive to business, tax competition from relatively low-tax countries that do not offer similar advantages will not seriously affect location choice. This view is consistent with the observation that a number of economies with large domestic output markets and strong FDI inflows have relatively high corporate tax rates. Therefore, the authorities in a host country should carefully consider whether tax incentives to foreign investors make sense at all. It may be more effective to improve the macroeconomic and industry-specific environment in order to create encouraging conditions for FDI.

A host country’s exchange rate policy in terms of its relative attractiveness to FDI inflows is another much discussed topic. Some economists argue that currency depreciation relative to key investment partners reduces the unit costs of a country’s production factors and thus can enhance FDI, especially to export-oriented sectors. There is other evidence that real apprecia-

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4 The literature on taxation points out that certain types of FDI may not be very sensitive to taxes, moreover the effects of taxation on FDI can vary substantially by type of tax, measurement of FDI activity, and tax treatment in the host and parent countries.


6 OECD (2008)
tion of the domestic currency may encourage FDI factor as it increases the foreign currency value of the profit repatriated to the parent company. However, from a macroeconomic standpoint the most credible strategy is to maintain the real exchange rate in line with key trading partners; economists increasingly agree that the level of the exchange rate does not alter firms’ decision to invest in a foreign country, except in the case of large sudden exchange rate swings.

3. Analysis of selected countries

This section considers policies and measures are used by countries that achieved the impressive results in FDI attraction and foreign capital utilization. According to a survey which interviewed 809 global investors in Western and Central and Eastern Europe in February 2009, China ranks third among the most attractive countries in the world in which to establish or expand operations, India is fifth, and Brazil occupies seventh place. Poland ranks fifth in Europe and first in the CEE region in terms of new foreign investments in 2008 and second in Europe regarding the number of new jobs generated by FDI. Ireland ranks ninth among the top 15 most attractive destinations for inward investment in Europe. Forbes magazine considered Slovakia as the world’s next Hong Kong or Ireland.

3.1. China

China is a great example of a country that succeeds in FDI attraction. As a result of active government promotion through various policy measures over the last decade China has attracted about 25% of all FDI directed to developing countries, of which more than 80% was received in form of greenfield investment and 70% are in manufacturing. It is expected that in 2006–2010 China's share will increase to 30% of the projected USD 250 billion of FDI inflow into developing countries.

The main motives for investment in China are the factor cost advantage due to low labor costs (resource seeking) and the growing demand of the Chinese market (market-seeking FDI). An equally important factor in attracting FDI was the participation of foreign investors in the privatization process of state-owned enterprises. Some studies point to the fact that the large inflow of FDI is not only the consequence of good policies, but also results from certain distortions in the Chinese banking market and in state investment policies.

Since the beginning of economic reforms in 1979, China’s policies toward FDI have experienced serious changes. It started from gradual and limited opening, followed by active promotion of FDI in general, to encouragement of more high-tech and more capital intensive FDI projects in accordance with domestic industrial objectives.

In the first phase, four Special Economic Zones (SEZs) that offered special incentive policies for FDI were established in the eastern region. This led to investment inflow but on the other hand it resulted in huge development gap between coastal and inland provinces and caused so-called FDI “round tripping”. Therefore in 1992 newly adopted FDI policies and regulations shifted the focus from special regimes toward a more nation-wide strategy. Within the framework of this strategy China provided many incentives for foreign investors. Article 22 of the Provisions of the State Council of the People’s Republic of China for the Encouragement of Foreign Investment envisages preferential tax treatment for foreign joint ventures. For instance, income tax exemptions were offered to foreign enterprises in the first and second years, and a 50% income tax reduction was offered from the third to fifth years. In addition, reduced income tax rates were levied on foreign investment enterprises in special economic zones and open coastal regions–15 and 24%, respectively, instead of the usual 30%.

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7 Reinventing European Growth, Ernst & Young 2009 European Attractiveness Survey.
8 Reinventing European Growth, Ernst & Young 2009 European Attractiveness Survey.
10 Poncet Sandra (2007). Inward and Outward FDI in China. Panthéon-Sorbonne-Economie, Université Paris 1 CNRS and CEPII.
11 Round tripping appeared when domestic investments in China where routed to Hong Kong and then sent back to China in order to take advantage of preferential policies available only to foreign investors.
provided the freedom to import inputs such as materials and equipment, and simpler licensing procedures. Additional tax benefits were offered to export-oriented joint ventures and those employing advanced technology. The government also attempted to guarantee the autonomy of joint ventures from external bureaucratic interference, to eliminate many unfair local costs.\(^\text{13}\)

All FDI projects in China were accessed and classified according to the Guiding Catalogue of Foreign Investment Projects into one of four categories: encouraged, restricted, prohibited, and permitted. Priority was given to export-oriented projects, and those which manufacture new equipment or materials, involved new technology or could take advantage of China’s rich natural resources and relatively low labor costs. FDI in infrastructure, agriculture and basic raw materials was highly encouraged as well.

At the end of 2006, the National Development and Reform Commission, which is the economic planning agency in China, announced a new governmental policy towards FDI for the next five years that implied a transition from a quantity to a quality approach in attracting foreign investors. It put emphasis on the shift from FDI in low-value export-processing and assembly-type manufacturing towards investment in higher-value-added sectors; it discouraged unscrupulous pursuit of FDI by local authorities; and it increased environmental standards applicable to projects run by foreign firms. In 2007 the new Enterprise Income Tax Law withdrew all tax privileges for FDI and unified the income tax rates for all enterprises at 25%. A new 28-page guide on FDI was adopted at the same year with the aim of redefining the scope of investment. According to these guidelines, foreign investors are invited to join efforts to promote the recycling economy, clean production, renewable energy utilization and ecological environment protection. Manufacturing is open to FDI in high technology, but FDI is not allowed in traditional industries. The idea is to spur innovation, industrial restructuring and redress regional imbalances with the help of FDI.\(^\text{14}\)

Despite the fact that China's investment climate is strong overall, increasing competition from some emerging economies (e.g. India, Brazil) suggests that the country should continue to improve it by making inward investing more convenient. According to a recent study conducted by the World Bank Beijing Office, the attractiveness of the investment climate can be increased if China reduces the complexity of investment approvals; increases government effectiveness by reducing overlap in authority and duplication in registration and approval requirements among agencies; improves access to equity finance by foreign-invested firms through capital market reforms; and reforms its judicial system.\(^\text{15}\)

3.2. India

As a result of policy measures that have been implemented since 1991 with the aim to liberalize the FDI environment, India has become a most attractive place for inward investment.

Foreign Investment Policy

a) FDI approval process

One of the important steps on the way to the creation of a liberalized and transparent investment climate was the simplification and shortening of FDI approval procedures. As a result, most foreign investment can come to India by the so-called automatic route. Nowadays only a few sectors in India are entirely closed to foreign participation for political or national security reasons. They are: retail trading (except for single brand product retailing); atomic energy; lotteries, gambling and betting; agricultural or plantation activities of agriculture. FDI that comes under the automatic route does not require any prior approval either by the Central Government or Reserve Bank of India (RBI). Investors are only required to notify the regional office of the RBI within 30 days of the receipt of inward remittances and file the required documents with that office within 30 days of the issue of shares to foreign investors.\(^\text{16}\)

case of construction of building, water, environmental clearance, etc., additional regulatory approvals must be obtained from the state governments and local authorities. For a limited category of sectors foreign investment and foreign technical collaboration can come into India via the **prior government approval route**, whereby proposals are considered in a time-bound and transparent manner by the Foreign Investment Promotion Board (FIPB). Such procedure is requested for: activities that require an industrial license; proposals in which the foreign collaborator has an existing financial/technical collaboration in India in the same field; proposals for acquisitions of shares in an existing Indian company in the financial service sector.

b) **FDI related institutions**

**The Foreign Investment Promotion Board (FIPB)** was constituted within the Ministry of Finance as a one-stop investment promotion agency and is responsible for foreign investment facilitation, negotiation/discussion with potential investors, early clearance of proposals, and reviewing policy and putting in place appropriate institutional arrangements, transparent rules and procedures and guidelines for investment promotion and approvals; identification of the sectors into which investment may be attracted keeping in mind national priorities and also the specific regions of the world from which inward investment may be invited through special efforts.\(^\text{17}\)

**The Foreign Investment Implementation Authority (FIIA)** was created with the aim of shortening the way between FDI approval and implementation. It provides one-stop after service care to foreign investors by helping them obtain necessary approvals, sort out operational problems and meet with various Government agencies to find solution to their problems.\(^\text{18}\)

In addition, the **Secretariat for Industrial Assistance (SIA)** was established at the Ministry of Commerce and Industry to provide single window entrepreneurial assistance, processing all applications that require government approval, assisting investors in setting up projects (including liaison with other organizations and state governments) and in monitoring the implementation of projects.

c) **FDI incentives**

One of the most important incentives provided for FDI in India relates to taxation policy as tax rates in the country are sufficiently high. Domestic corporations are subject to tax at a basic rate of 35% and a 2.5% surcharge. Foreign corporations have a basic tax rate of 40% and a 2.5% surcharge.\(^\text{19}\)

Tax incentives include tax holidays or reduction of corporate profit tax, accelerated depreciation allowance, and tax deduction of certain expenses (e.g. R&D expenses). For instance, India was able to attract much FDI into the IT industry by offering a 10-year tax holiday. Investment in the infrastructure sector, power distribution, certain telecom services, refining of mineral oil, R&D projects, food processing and some other activities enjoy special tax treatment and holidays as well. For example, infrastructure projects – road, highways, irrigation projects, sanitation and sewage projects, and solid waste management systems – receive 100% deduction of the profits for 10 years.\(^\text{20}\) The government offers 5-years tax holidays for power projects and firms engaged in exports, other tax rebates are also provided for specific sectors and activities.\(^\text{21}\)

Tax holidays are available in Special Economic Zones (SEZ) set up to create internationally competitive and favorable environment for exports. The SEZ regulations offer tax exemptions from 50 to 100% over a fifteen year period: 100% income tax exemption on export income for SEZ units is offered for the first 5 years, 50% for next 5 years thereafter and 50% of re-invested export profits for next 5 years. In addition duty free import/domestic procurement of goods for development, operation and maintenance is granted for SEZ units.\(^\text{22}\) However, there

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\(^\text{17}\) finmin.nic.in/fipbweb/fipb/fipb_index.html.
\(^\text{18}\) http://siadipp.nic.in/sia/filia.htm.
\(^\text{19}\) India Business Directory: business.mapsofindia.com/...tax/income-tax.html.
\(^\text{22}\) Background note Special Economic Zones in India. Government of India, Ministry of Commerce & Industry.
are controversial opinions concerning the successfulness of India’s SEZ policy. Some studies point out that such extensive tax holidays and other privileges for investors appear to be redundant as, for example, a government audit report found customs duty loss caused by SEZ amounting to 1.7 billion dollars, which is 60% higher than their export earnings.²³

3.3. South Korea

Since 1998 Korea has been conducting an aggressive FDI inducement policy with the aim of recapturing foreign investment and attracting it away from China and Singapore. The implemented measures have resulted in sharp increase in investment flows. In 2001–2007 Korea managed to attract yearly around USD 10 bn of FDI on average, most of which came in form of greenfield investment (76.4% of total FDI in 2007) and flowed mainly into the electronics (LCDs) and chemical industries. Manufacturing-focused investment accounted for 38% of total FDI, while 60% was directed to the service sector (basically in health and sanitation).

Table 2: FDI Incentives in Korea

<table>
<thead>
<tr>
<th>Qualifications</th>
<th>Benefits</th>
<th>Procedure</th>
</tr>
</thead>
<tbody>
<tr>
<td>High-tech status</td>
<td>Business within the category of: − High-tech business, or − Industry support service.</td>
<td>Tax Holidays (5 years 100%, 2 years 50%): − Lease of land in Industrial complex, − Financial support for employment and training.</td>
</tr>
<tr>
<td>Foreign Investment Zone</td>
<td>Manufacturing − FDI USD 30 m*, − New Establishment of Plant R&amp;D. − High-tech status, − New R&amp;D Facilities &amp; FDI USD 5 m, − Over 10 R&amp;D personnel.</td>
<td>Tax Holidays (3 years 100%, 2 years 50%): − Lease of land, − Support for basic infrastructure, − Financial support for employment and training.</td>
</tr>
<tr>
<td>Cash Grant</td>
<td>High-tech status (or Parts and Material Specialty) − New Plant Facilities and FDI USD 10 m. − R&amp;D − New R&amp;D Facilities and FDI USD 5 m, − Over 20 R&amp;D personnel.</td>
<td>Granted Cash can be used for: − Employment and Training, − Land Acquisition and Rent, − Construction Cost, − Set-up Cost for Basic Infrastructure, − Purchase of Capital Goods, − R&amp;D equipment and Materials.</td>
</tr>
</tbody>
</table>

Note: The required investments for tourist and logistic companies are lower and amount to USD 20 m and USD 10 m, respectively.


After the Asian financial crisis Korea introduced new FDI-enhancing policy providing investors with a wide range of incentives, which include tax exemptions and reductions, financial support for employment and training, cash grants for R&D projects, and exemptions or reductions of leasing costs for land for factory and business operations for a specified period (see Table 2). The major tax incentives are granted to projects that have high-tech, R&D or industry-supporting status and to businesses located in Foreign Investment Zones. They include tax holidays on corporate profit for five years from the year in which the initial profit is made, and a 50% reduction for the following two years.²⁴ For these types of projects some other benefits in the form of financial support for employment and training, and heavily subsidized lease of government owned land are offered as well. High-tech greenfield investment and R&D projects

²⁴ In the Foreign Investment Zones exemptions from land fees, income and corporate tax are offered for the first three years, followed by a reduced rate of 50% in the subsequent two years. Incentives also include simplified administrative procedures, administrative services in English, and educational and medical services to foreign workers.
can in addition receive cash grants. The government expects that the FEZs will become a template for the economy and intends to apply the same rules and regulations to the rest of the country.

Understanding the importance of aftercare service to foreign companies as a tool for improving Korea’s attractiveness as an FDI destination, the government has established the Office of the Investment Ombudsman in addition to the investment promotion agency (KOTRA).

**Box 1: The Grievance Resolution Process in Korea**

The resolution process takes many forms. Generally, senior consultants, better known as “home doctors,” play a major role in the decision-making process. In the first stage, senior consultants do intake and evaluation in order to determine how a case should be processed. Then, they consult with representatives from relevant government agencies. After a case is reviewed and opinions exchanged between the home doctors and the Ombudsman, senior consultants submit a grievance resolution proposal through official channels. In the event that a case is rejected, the matter can be brought before the Foreign Investment Working Committee, the Regulatory Reform Committee, and/or the Office for Government Policy Coordination. A request for intervention can also be brought to the Ministry of Knowledge Economy’s Business Grievance Consulting Center. Although grievances can be submitted to the Foreign Investment Working Committee, the process of doing so has proved ineffective due to the fact that meetings are held only on a quarterly basis. When cases require swift resolution, since convening meeting and holding subsequent hearings may require more time, working through the Foreign Investment Working Committee may not be preferable for foreign investors. For cases in which transnational corporations filed grievances requiring systemic changes, regulatory reform and/or amendments to enforcement decrees, the Foreign Investment Ombudsman acts on their behalf, directly contacting the heads of relevant agencies and submitting proposals. The Foreign Investment Promotion Act dictates that government agencies should reply within a week once they receive a recommendation from the Ombudsman.


The Office of Foreign Investment Ombudsman helps foreign companies to overcome government bureaucracy and to resolve grievances that arise in the areas of taxation and tariffs, labor-management, accounting, construction, technology standards, law, customs and trade, investment process and etc. The efforts undertaken by the Foreign Investment Ombudsman led to a rise in the grievance resolution rate from 27.1% in 2001 to 95.8% in 2007. In addition, cooperation between the Office and the other governmental agencies brought about an improvement of FDI regulations.

3.4. Brazil

Attracting USD 42 bn of FDI in 2008, Brazil proved to be the largest recipient of FDI in Latin America. Evidently market-seeking motives determine the inflow of investment into the country, but they are complemented by government policy that focuses on the creation of a liberal regime for FDI, and an attractive environment for investment. The bulk of the inflow was in form of M&A (mergers and acquisitions) related to the privatization of the electricity, telecommunications and financial sectors. In general there is no impediment to the inflow of foreign capital, however, its participation is limited or prohibited in: development of activities involving nuclear energy; ownership and management of newspapers, television, radio networks, etc.; health services; ownership of rural areas and businesses on frontier zones; mining; post office and telegraph services; airlines with domestic flight concessions and the aerospace industry.

Brazil is an excellent example of a country that managed to get FDI without granting special incentives for foreign investors who came mostly due to liberalization and structural reforms,

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25 For example in 2004 the government announced plans to provide cash subsidies to foreign companies setting up R&D facilities proportionally to the number of Korean employees, and to pay part of the wages for up to 100 jobless Korean graduates of engineering universities and graduate schools who are hired by foreign-owned R&D centres.


27 the Brazilian Central Bank reported USD 45 bn.

28 Legal Guide for the Foreign Investor in Brasil.
privatization and deregulation. Tax benefits and other incentives offered by the Government of Brazil and local governments are applied without discrimination to both foreign and domestic firms. Moreover Brazil is one of the few countries that does not have an FDI promotion agency at either the federal or the state level. All incentives to investors in Brazil are either horizontal, sectoral or regional.

**Horizontal incentives**

Brazil offers some incentives in order to promote exports as well as technology research and innovation by reduction of domestic taxes or exemption from the withholding tax. The most important incentives are:

- special basis of taxation for the export of technological information services;
- special tax incentives for exporting companies in the acquisition of fixed assets and equipment;
- special tax incentives for computer manufacturing companies investing in new technology;
- fiscal incentives for new projects in North and North-Eastern Brazil.  

For example, in 2007 Brazil adopted Law 11529 that allows certain Brazilian industrial sectors (textiles, furniture, ornamental stones, woodworking, leatherworking, shoes, leather goods, heavy and agricultural machinery manufacturers, apparel and automotive – including parts) to apply for PIS-COFINS (social integration program) tax credits for the purchase of capital goods, both domestic and imported, that are used for manufacturing finished products. The law also expands the government’s program for exporting companies purchasing capital goods. To be exempt from paying the 9.25 percent PIS-COFINS tax on these purchases, companies must prove that they derive at least 70% of their revenues from exports. This benchmark was lowered to 60% for companies in the sectors covered by the legislation.

In 2001 a tax reduction regime for imports of capital goods for which no similar product is produced nationally (“ex-tariff”) came into effect. The intention is to foster expansion and restructuring of national industrial capacity through reduction of the import tariff (from 14% to 2%) on machines and equipment not produced in Brazil. Exemptions from paying the federal excise tax on industrialized products and the federal state value added tax on services and circulation of goods are also granted within this programme. The pulp and paper, textile, steel and auto parts sectors are the main beneficiaries of this ex-tariff regime.

**Sectoral incentives**

In 1990th Brazilian Government applied the special auto regime that provided for a reduction in import taxes on capital goods and raw materials for companies investing in the manufacturing of autos, trucks, buses, tractors, breakdown trucks, parts, accessories, components, kits and subkits and tires in Brazil. The Regime was valid until 31/12/99 in the South and Southeast and applies until 2010 in the North, Northeast and Mid-West States.

In 2005, Law 11196 provided special tax breaks, direct assistance and other incentives to export firms, investments in information technology and R&D projects.

A number of tax incentives are offered to firms engaged in Brazil’s agro-industrial technology development programmes. These incentives allow:

- Accelerated amortization of some intangibles;

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29 In Brazil, an FDI promotion agency called “InvesteBrasil” existed for a short period of time (1999-2002). Nowadays, RENAI (National Network of Investment Information) provides information about investment opportunities in Brazil.

30 Brazil Tax Guide 2009.

31 PIS – social integration program contribution: These contributions are payable each month (1.65% of monthly gross income) as a fund to employees. COFINS – social security contribution: COFINS are payable each month as a contribution to the health, social work assistance and social security program of the Federal Government. The COFINS rate is 7.6% of the monthly gross income of the company.


33 The reduction of the import tax on machinery and equipment to 2% is expected to continue until the end of 2010.
- Accelerated depreciation on domestically produced equipment;
- Double deduction of technology development expenses, limited to 8% of the basic income tax liability;
- Reduction of up to 50% of withholding taxes due on remittances of royalties and technical services fees; and
- Increase in the deduction of royalty and transfer of technology expenses to 10% of related gross sales.

Some of these incentives will be progressively reduced up to the tax year 2013.

Responding to a drastic reduction in infrastructure investments in Brazil, the government recently introduced sectoral investment regimes for infrastructure services. For example, a Public-Private Partnership (PPP) investment law adopted in 2004 promotes joint ventures and investment in marginally profitable infrastructure. In addition the Program to Accelerate Growth (PAC) launched by the Brazilian government in 2007 set attraction of private sector investment in infrastructure using government resources as an object.

Regional incentives

Regional incentives are designed to encourage the economic and social development of certain areas of the country. For example, in the Northeast and the Amazon regions – which are less developed parts of the country – the incentives help to attract foreign companies to the Manaus Free Trade Zone.

Box 2: Manaus Free Trade Zone

The Manaus Free Trade Zone (FTZ) was established in and around the port of Manaus on the Amazon river as a manufacturing park, where radios, television sets, videocassette recorders, motorcycles, and other goods that depend on imported parts are assembled. It also comprises a trading centre and an agricultural and ranching district. 400 companies, which employ 50,000 people in the Manaus region, are operating in the Manaus Industrial Sector.

Manaus FTZ is managed and promoted by Suframa, a government agency under the Ministry for Development, Industry and Foreign Trade.

The companies located at Manaus FTZ enjoy the following incentives:

**Federal Government Incentives**

**Corporate tax reduction** – Eligible corporations may receive a 75% corporate tax reduction on "exploration profits" until 2013.

**Import tax reduction and exemption** – Eligible corporations established in the Manaus FTZ may receive import tax reduction and/or exemption granted by the Federal Government of Brazil as follows:
- Foreign goods entering the Manaus FTZ that are destined for internal consumption and re-exportation are exempt from import tax;
- Certain eligible foreign goods destined for the western Amazons region are exempt from import tax;
- Import tax reductions may be applied to eligible "raw materials, intermediate goods, secondary materials and packaging materials" from foreign destinations if these good are used in the manufacturing process of companies established in the Manaus FTZ and the finished goods is destined to another area in Brazil. Such reductions are pending pre-approval from Suframa and certain other statutory and formulary restrictions;
- Excise tax exemption applies to eligible foreign goods traded within the Manaus FTZ, as well as to foreign goods utilized within the zone subject to certain restrictions. The excise tax exemption is also applicable to goods produced within the Manaus FTZ and to domestic goods entering the zone; and
- Export tax exemptions apply for goods produced within the Manaus FTZ.

**State Government Incentives**

- Value Added Tax exemption – The State of Amazonas provides an exemption from VAT on eligible goods for consumption or industrialization or re-exportation by other Brazilian States to the Manaus FTZ;
- Value Added Tax credit – The State of Amazonas grants a VAT credit equal to the amount payable at the point of origin for goods manufactured in other Brazilian States as these goods enter the Manaus FTZ; and
- Value Added Tax refund – VAT on eligible goods is refunded subject to certain conditions.

**Municipal Government Incentives**
- Tax exemptions – Corporations established in the Manaus FTZ are exempt from paying applicable municipal Housing, Territorial and Urban Real Estate Tax, as well as from paying tax for waste disposal and conservation, for a period of 10 years; and
- Other Incentives – The Manaus FTZ offers an exemption from paying a corporate license fee for a period of 10 years, subject to certain conditions.

Source: www.suframa.gov.br/publicacoes/site_suframa/english/pagina_05.htm.

In 2008 Brazil’s House of Representatives approved Provisional Executive Act 418, which promotes the use of export processing zones (ZPEs) in order to spur the economic development of the North, Northeast and West-Central regions. According to the Act manufacturers operating in an export processing zone that export 80% of their production can obtain the following benefits:

- “The Government will suspend for 20 years the obligation to pay import duties, federal value-added taxes, social contributions, social integration program contributions, foremanship, warehouse fees and merchant marine fund contributions on imports and domestic purchases of goods and services.
- The Government will eliminate of the requirement that the qualified manufacturer obtain (and pay the required fees for obtaining) an import license or other federal agency authorization for imports and exports, except those related to sanitary controls, national security and environmental protection.
- The Government will forego certain amounts of income tax revenue by granting a full income tax exemption during the first five years and 75 percent reduction during the following five years. There are certain restrictions for foreign corporations.”

The incentives to investors can be also granted by the states/local governments in form of ad hoc tax benefits and infrastructure support to specific companies, negotiated on a case by case basis. However, quite often states, willing to attract investment, compete to provide the largest tax-incentives to foreign companies. In order to put an end to these “tax reduction wars” Brazilian Legislature is going to limit states’ ability to offer tax incentives for investors in the framework of tax reform to be conducted in 2009.

3.5. Ireland

As a result of the Irish Government’s pro-active FDI policy the total stock of inward investment increased over last ten years from EUR 53 bn to EUR 131 bn, spurring economic growth and turning the country into the so-called “Celtic Tiger”. Ireland most welcomes foreign enterprises that invest in technology-intensive, high-skill industries, enhance R&D activities, and produce higher-value goods and services. In 2008 6,300 job were created in the country due to 108 FDI investment projects in the area of business services, software, scientific instruments, electronics, pharmaceuticals, and financial intermediary services. Ireland has prospered by attracting such world class global companies as Yahoo, Google, Amazon, Microsoft, IBM, and Citibank etc.

The Industrial Development Authority of Ireland (IDA Ireland) is the main agency in charge of promotion and facilitation of FDI in the country (except the Shannon Free Zone that is under responsibility of Shannon Free Airport Development Co. (SFADCO), or “Shannon Development”). In addition there is the agency – Enterprise Ireland – that promotes joint ventures and strategic alliances between indigenous and foreign companies.

The main determinants of Ireland’s attractiveness for FDI are a low corporate tax rate for domestic and foreign firms (12.5%); the quality and flexibility of the English-speaking work force; cooperative labor relations; political stability; pro-business government policies; a transparent judicial system; and, the pulling power of existing companies operating successfully in Ireland (a "clustering" effect).

35 This rate has been applied since January 1, 2003, however, the "old" 10 percent rate will be kept until 2010 for foreign firms that invested in Ireland prior to this date and engaged in manufacturing in the case of manufacturing and production internationally traded services.
The Irish government also encourages investors by offering grant aid for capital equipment, land, buildings, training, R&D, etc. Foreign and domestic firms that seek support must submit investment proposals to IDA Ireland and SFADCO that administer grants. The company must guarantee repayment of the government grant if it closes before an agreed period of time, normally ten years after the grant has been paid. In 2007, IDA Ireland provided EUR 78.5 m of grant assistants to foreign firms.37 As the government strongly encourages investment in regions and provides financial support with this object in view, nearly 60 percent of greenfield projects in 2006–2007 were located outside of Dublin.

### Box 3: The Shannon duty-free Processing Zone (SDFPZ)

The SDFPZ was established in 1957. Currently, over 100 companies employing over 7000 workers operate in this Zone. The main business activities are: aerospace, software, engineering, supply chain management, financial services, pharmaceuticals, and electronics production. Firms operating in the SDFPZ enjoy the following benefits: a 12.5% corporate tax rate; duty-free imports of goods for processing from non-EU countries; duty-free exports of goods from Shannon to non-EU countries; minimum customs documentation and formalities; zero Value Added Tax (VAT) on imported goods, including capital equipment; grants for employment, R&D, training, and capital equipment. In addition, companies established in the SFZ may obtain R&D tax credits and exemption for Capital Gains Tax.


### 3.6. Poland

Poland has achieved considerable success in attracting foreign capital; since 1990 it has obtained more than USD 120 bn of FDI. By constantly improving the investment climate, e.g. by reducing the tax burden (in particular, lowering disability insurance contributions), simplifying foreign exchange law, improving the bankruptcy law, and relaxing regulations in some sectors (in particular telecommunication) etc., the country has turned into a magnet for new foreign investment projects in Europe.

Nowadays there are no performance requirements on establishment of businesses by foreign firms or restrictions on their entry, however, in some sectors, e.g. broadcasting and air transport, there are authorization requirements and foreign equity limits. In addition, government concessions, licenses or permits must be obtained if investors want to engage in such activities as broadcasting, aviation, energy, weapons, mining, and private security services.

Poland provides the following benefits to foreign investors:

- Income tax and real estate tax exemptions in Special Economic Zones (SEZ);
- Investment grants of up to 50% (70% for small- or medium-sized enterprises) of investment costs;
- Employment grants of up to EUR 5,000 per new employee;
- Grants for research and development;
- Grants for other activities, such as environmental protection, training, logistics or creating renewable energy sources;
- Sales of government-owned brownfield and greenfield locations at attractive prices;
- Potential partial forgiveness of commercial debt owed to a state-owned bank incurred for the acquisition of technology; and
- Varying incentives related to acquiring or developing new technology.38

### 3.7. Slovakia

FDI has been playing a very important role in the modernization and transformation of the Slovak economy. By creation of market-friendly environment and liberalization of investment climate the country narrowed the FDI gap with its neighbors and become one of Europe’s most attractive places for foreign capital. In 2008 total volume of FDI amounted to USD 37.8 bn, and according to UNCTAD was the highest among neighboring countries in terms of FDI per

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capita. Such European and global companies as Samsung, Sony, PSA Peugeot Citroen, Kia Hyundai, Getrag Ford, Volkswagen and DELL have realized projects in Slovakia.

The factors determining high rate of investment influx to Slovakia are as follows:

- A flat income tax rate of 19 percent, both for corporations and individuals, which is the most advantageous among all OECD and EU countries;
- A zero withholding taxes on dividends;
- Several forms of state aid for foreign investors: discounted prices for land, financial subsidies for acquiring tangible and intangible assets related to the investment, tax credits, and grants for the creation of new jobs. According to Act on Investment Aid that has been valid since January 2008 domestic and foreign investors can obtain assistance for the period 2007–2013 for investment or expansion projects of industrial production, technology centres, strategic service centers, and complex tourism centers depending on a number of factors including level of unemployment in the proposed region of investment, business sector, size of investment, and the type of employment that will be provided. The Act is designed to encourage investments into high value-added products and R&D or into less-developed regions with high unemployment;39
- Additional support from regional governments in various forms including infrastructure and training;
- Absence of formal performance requirements for establishing, maintaining, or expanding foreign investments. However, such requirements may be included as conditions in the case of large-scale privatization;
- Foreign entities can participate in research and development programs financed or subsidized by the Slovak Government and receive the same treatment as domestic entities.

4. Impact of economic and financial crisis

FDI has been negatively affected by economic and financial crisis as it dampens the prospects for economic growth, which is the main engine of FDI (see Table A2). According to the UNCTAD World Investment Report almost all sectors with the exception of oil, mining and agriculture food have been affected by a decrease in FDI, and global investment inflows are expected to fall by 30 % in 200940 due to:

- Limited access to domestic and external financial resources owing to the credit crunch and the tightening of credit conditions;
- A decline in corporate profits that in turn decreases companies’ self-financing capabilities;
- A decrease in the propensity to invest as a consequences of the deterioration of the business environment, increased uncertainty and unclear economic prospects. All these factors worsen the risk outlook.

International crisis has different impact on the different types of FDI (see box 4). It was particularly harmful to mergers and acquisitions (M&As) in 2008 as firms revise their investment plans and cut spending. The effect on Greenfield investment became apparent in 2009 because firms postponed or canceled large number of investment projects at the fourth quarter of 2008. On the other hand, there are still some factors that support FDI and can contribute to future increase in inflow. E.g. financial and economic crises offer opportunities to firms that are willing to increase the level of internationalization as they can buy assets at “bargain prices”. According to E&Y Europe still remain favorable locations for FDI, particularly market-seeking FDI. Furthermore, new sources of FDI have appeared as some emerging economies (e.g. China) and countries well endowed with natural resources aggressively conducted outward investment (e.g. most of FDI attracted by Viet Nam came from such countries as China, Hong

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In general, countries do not adopt any special FDI-related programs and measures in response to financial crisis, but economic stimulus packages or initiatives were undertaken in order to support national business and households undoubtedly impact FDI flows in an indirect manner but it difficult to say at what extent. For example, the United Kingdom announced a value added tax cut, and Germany launched a financial package to help small and medium-sized enterprises in difficulty to access credit. Many countries – such as France, Germany, Spain and the United States – have also announced large public investment programmes mainly aimed at infrastructure development. China, India, Malaysia, Vietnam, Republic of Korea, Thailand announced a public investment plan to boost economic growth. Corporate tax rates have been lowered, for instance, in the Philippines (from 35% to 30%) and the Republic of Korea (from 13–25 % to 10–20%).

Box 4: Various types of investment motives (market-seeking, efficiency-seeking and resources-seeking) are affected unequally by the crisis

All three are impacted by the ongoing financial and economic crisis, but with differences in magnitude and location pattern of impact. The most directly affected types of investment so far have been market-seeking projects, especially those aimed at developed countries. As advanced economies are expected to experience negative growth in 2009, companies are restraining the launching of new projects aimed at increasing their market-oriented production capabilities there, while they remain more committed to capacity expansion in emerging and developing economies.

The impact of the crisis on efficiency-seeking projects is more difficult to assess. On the one hand, these projects will suffer globally from the decline in the companies’ financial capabilities. On the other hand, many companies might be compelled by the ongoing crisis to restructure their international activities to cut cost and boost overall efficiency. This means above all closing or downsizing obsolete or non-cost-competitive facilities (often located in advanced economies), but also opening some new cost-efficient facilities, especially in emerging economies.

Finally, resource-seeking FDI projects has been less hit but they could suffer, at least in the short-term, from the decline in world demand and consequently in prices, with particularly negative effects on resource-rich developing countries. But once the present recession is over, putting resource-seeking FDI back on the road to growth.


5. Conclusions and policy recommendations on measures for promoting FDI in Belarus

International experience show that countries which succeed in FDI attraction have been implementing policy that provides foreign investors with favourable environment and helps them to conduct business activity without incurring unnecessary risk. However, it implies not only the provision of incentives (e.g. tax exemption or reduction, financial subsidies, decrease import tariffs and etc.) but implementation of general policy measures that ensure stable macroeconomic environment. Therefore rising inflation rate, which resulted in an erosion of local purchasing power, slow implementation of privatization programme, dominance of government sector, tight price control, heavy tax burden and complicated system of taxation, bureaucracy, corruption (despite serious efforts undertaken by the Government corruption remains present according to Transparency International) are serious challenges facing FDI in Belarus. To improve the investment climate the Government should ensure stable macroeconomic environment, speed up privatization, improve business environment and increase its predictability, take measures to combat bureaucracy, corruption.

43 Belarus has undertaken steps towards easement of the tax burden by abolishing the “Chernobyl tax” (3 %) and unemployment tax (1%) and amending the simplified tax system for small businesses.
45 According to the World Bank’s Doing Business Report Belarus in 2009 ranks 58th on the ease of doing business out of 183 economies and appeared at the 10th DB reformer. However, despite this accomplishments a lot of work still should be done to create a favorable business environment.
Taking into account that the main objective of FDI is to serve long-term development goals and enhance competitiveness it should be a quite consistent match between the foreign direct investment attraction policy and industrial policy. Therefore FDI incentives should be elaborated based on Belarusian Government vision of the future industrial landscape as investors’ priorities depend on the sector they are going to invest. For example, according to Ernst&Young Investment Attractiveness Survey companies operating in high-tech and business services tend to favour quality factors such as telecommunication infrastructure (very important to 61.5% business-to-business companies) and labour skill level (very important for 53% of them). Industrial companies are most focus on cost efficiency (labour cost are very important for 50% of them), tax burdens, legal and regulatory factors.46 Hence, investors should be carefully targeted based on sector prospects and investment motives, e.g. such policy measures as development of physical and technical infrastructure and promotion of clusters, development of human resources can effectively help to attract FDI at high value added sectors and benefit from it.

In addition some recommendations can be drawn from selected countries experience:

- Creation of the effective aftercare services that address problems that investors are facing in their business in Belarus (taxation, finance, regulation of labour and etc.) and provide assistance in resolving difficulties can increase the attractiveness of the country;

- Such incentives as investment grants (employment, R&D, training and etc) can encourage greenfield FDI or investment in regions (outside Minsk or oblast cities)

- As FDI is rather sensitive to the tax burden at least corporate tax should be lowered and the friendliness of the tax administration should be increased.

- Taking into consideration that Belarus is relatively small country the necessity of the existence of six free economic zones (FEZ “Brest”, FEZ “Minsk”, FEZ “Vitebsk”, FEZ “Mogilev”, FEZ “Gomel-Raton”, FEZ “Grodnoinvest”) should be thoroughly analyzed. First, such FEZ can create the effect similar to Chinese “round tripping” when domestic investments might be routed abroad and then sent back to Belarus in order to score an advantage of preferential policies available to foreign investors. Second, FEZ policy and incentives should be closely matched with industrial policy and priorities. Third, establishing of more favorable conditions for economic activity should be general economic policy guidelines, and provision such conditions only for FEZ residents is not sufficient for achieving success in FDI attraction.

46 Reinventing European Growth, Ernst & Young 2009 European Attractiveness Survey
**Appendix**

**Table A1: Summary of the Possible Implication of Financial Crises for FDI in the Short-to-Medium Term**

<table>
<thead>
<tr>
<th>Variable affected by the crisis</th>
<th>Present evolution</th>
<th>Impact on FDI flow</th>
<th>Uncertainties in the medium term</th>
</tr>
</thead>
<tbody>
<tr>
<td>Availability of financial resources</td>
<td>Intensive credit squeeze (less availability and higher costs). Decreased company profits. Necessity to repatriate capital to compensate for losses</td>
<td>Growing financial constraints on investments, although some companies and institutions still have large amounts of cash</td>
<td>Speed of the recovery in the Financial sector and end of credit squeeze. Capacity of new types of investors (companies from emerging countries, SWFs), to act as a major engine of FDI growth.</td>
</tr>
<tr>
<td>Asset prices</td>
<td>Large decrease in the value of stocks</td>
<td>Reduced M&amp;A activity including leveraged buy-outs. At the same time, some M&amp;A operations are encouraged by companies well endowed with cash, but at a lower value</td>
<td>Recovery patterns of the stock-exchange market (with an impact on the value of international M&amp;As)</td>
</tr>
<tr>
<td>Market growth</td>
<td>Slowed world economic growth at least until 2009</td>
<td>Reduced incentives for market-oriented FDI, especially in developed countries</td>
<td>Time schedule and geographic patterns of the economic recovery</td>
</tr>
<tr>
<td>Degree of uncertainty</td>
<td>Very negative evolution of all available business confidence indices</td>
<td>Companies to restrain further investment plans and cut extensively in existing costs and assets, especially in hardly-hit advanced countries</td>
<td>A progressive return of Confidence is prerequisite new pick-up in investment</td>
</tr>
<tr>
<td>Public policies</td>
<td>Monetary and fiscal stimulus policies are being carried out in various countries in the word. The reform of the financial system has not yet begun: No specific impact on FDI policies, but existence of some neo protectionist tensions</td>
<td>No immediate direct impact so far</td>
<td>Capacity of public policies to ensure stability of the financial system, to renew commitment to an open attitude to FDI, to encourage investment and innovation, and to foster confidence of economic actors</td>
</tr>
<tr>
<td>Sector specific crisis and restructuring</td>
<td>Market-seeking FDI projects in developed countries are the most affected due to the looming recession there</td>
<td>Divestments, sales of assets and M&amp;As for restructuring in the most hard-hit industries</td>
<td>Speed and scope of the restructurings and shifts in market power triggered by the crisis (increased role of companies from emerging and developing countries?)</td>
</tr>
<tr>
<td>Location patterns of FDI</td>
<td>Market-seeking FDI projects in developed countries are the most affected due to the looming recession there</td>
<td>Export-oriented FDI projects in developing and emerging Economies (both efficiency and resource-seeking) could be increasingly affected due to the low dynamism of advanced country markets</td>
<td>Rising attractiveness of the south for both market oriented and efficiency-seeking FDI</td>
</tr>
<tr>
<td>New sources of FDI</td>
<td>Growing role of SWFs and companies from emerging countries (but financial sources somewhat squeezed in the short term)</td>
<td>Growing share of the emerging and developing countries in FDI outflow</td>
<td>Will FDI from the newer sources compensate for the decline in FDI from advanced countries?</td>
</tr>
</tbody>
</table>

*Source: UNCTAD.*