

# The Influence of Investment Incentives on the Foreign Direct Investment Confidence Index in the Czech Republic

## Vliv investičních pobídek na index důvěřivosti přímých zahraničních investic v České republice

Marcela Papalová<sup>1</sup>

### Abstract

Incentives are frequently used as a policy instrument to attract foreign direct investment (FDI) and to benefit more from it. They can be classified as financial, fiscal or other incentives. Incentives schemes are often used instead lower tax rates, as they seen as a form of direct economic policy targeting that is implemented to stimulate particular areas of economic activity.

The Czech Republic tries to attract domestic and particularly foreign investors too. The popularity brings evaluation by FDI Confidence Index. Interest of investors often derives from different information source.

### Key words

Investment incentives, index of confidence, foreign direct investment,

**JEL Classification:** F200

## 1. Introduction

The radical changes of the socioeconomic environment wait on transition from industrial era to postindustrial. Changes has influence on varies aspects of the life (Kirovová, 2007). Postindustrial era can be characterized by an explosion of information and communication technologies. The industries most affected by the high-technology trends are numerous and often interrelated. They include for example, electronic, communication industries, biotechnology, biomedical and pharmaceutical industries.

Government wants to encourage economic growth, GDP and productivity especially in those new industries, which it brings higher added value. Incentives are one tool benefits from the macroeconomic point of view. Investment incentives import micro contributions too. They enhance the competitiveness of organizations or yield creation of new jobs. On the other hands investment incentives are not systematic support and it is necessary to consider which branches would be granted.

---

<sup>1</sup>Marcela Papalová, PhD., Departament of Management, marcela.papalova@vsb.cz

## **2. Investment incentives**

### **2.1 Definition of investment incentives**

There is no unified definition of what constitutes an “investment incentives”. It is only possible to find the most frequently used incentives. According UNCTAD (Incentives, 2004, pp. 15): “Investment incentives means the grant of a specific advantage arising from public in connection with the establishment, acquisition, expansion, management operation, or conduct of an investment of a Contracting Party or a non-Contracting Party in its territory.” It is government scheme aimed at stimulating private sector interest in specific types of capital expenditure, or investment in areas of high unemployment or backwardness. These incentives may take the form of direct subsidies (investment grants) or corporate income tax credits (investment credit) that compensates the investors for their capital cost.

Incentives are frequently used as a policy instrument to attract foreign direct investment (FDI) and to benefit more from it. They can be classified as financial, fiscal or other incentives.

- a) financial incentives, such as outright grants and loans at concessionary rates;
- b) fiscal incentives such as tax holidays and reduced tax rates;
- c) other incentives, including subsidized infrastructure or services, market preferences and regulatory concessions, including exemptions from labor or environmental standards (Jahn, 2007).

### **2.2 The investment incentives in the Czech Republic**

The system of the investment incentives was originally approved by the Czech government in April, 1998. In December 1998, the minimum investment level was reduced to US\$ 10 million. Foreign and domestic investors can get support as pilot projects. Investors meeting the criteria could have applied for all or any of the following incentives:

1. Corporate tax relief for up to 10 years
2. Job-creation grants
3. Location in a customs-free zone
4. Duty-free imports of machinery and equipment
5. Training grants (Investiční pobídky v ČR, 2005)<sup>2</sup>

The act for the investment incentives was passed even two years later in 2000. This step created the basic conditions for investors. Applicants seeking an investment incentive were required to make a greenfield investment of at least USD 25 million. This limit was lowered to USD 10 million. The main target of the investment incentives was to motivate system foreign and Czech investments in advanced industrial technologies. The system was several times changed, especially necessitated by the Czech Republic's accession to the European Union and required for the transfer of competences in State aid from the Office for the Protection of Competition to the European Commission. Other changes connected with the latest amendment include a reduction in the minimum investment from 350 million CZK to 200 million CZK, unification of the tax— full corporate tax relief for up to 5 years (new legal entity), only up to the utilized or partial corporate tax relief for up to 5 years (existing legal entity), and the possibility for companies to lodge appeals and apply for judicial reviews of

---

<sup>2</sup> Investment Incentives in the Czech Republic

decisions issued by the Ministry of Industry and Trade on the granting of investment incentives.

### 3. Foreign direct investment confidence index

The FDI Confidence Index was designed to gauge the likelihood of investment in specific markets in order to gain insights into likely trends in future global FDI flows. Since the inception of the FDI Confidence Index ranking in 1998s constructed using primary data from a proprietary survey administered to a selected sample of senior executives of the world's 1000 largest corporations. The participating executives include CEOs, CFOs, board members, and senior corporate strategists from 24 countries and 14 specific industries (FDI Confidence Index Flash Survey, 2001).

#### 3.1 The Czech Republic ranking in the FDI Confidence Index

The index is calculate as weighted average of the number of high, medium low and “no interest” responses to a question about the likelihood of direct investment in a market over the next one three years. Index values are based on non source country responses about various markets. All index values have been calculate on scale of zero to three, with three representing highly attractive and zero not attractive.

Table no. 1: FDI Confidence Index 1998-2010

Year/ Rank	1998	1999	2000	2001	2003	2004	2005	2007	2010
1.	US	US	US	US	China	China	China	China	China
	2,22	1,80	1,82	2,03	1,97	2,03	2,197	2,21	1,93
2.	Brazil	China	UK	China	US	US	India	India	US
	2,06	1,3	1,52	1,69	1,63	1,45	1,951	2,09	1,67
3.	China	UK	China	Brazil	Mexico	India	US	US	India
	2,02	1,18	1,41	1,5	1,06	1,4	1,42	1,86	1,64
CR	16.	16.	18.	16.	13.	14.	12.	25.	17.
	1,62	0,81	1,11	1,2	0,88	0,93	1,136	1,56	1,25

CR – Czech Republic, US- United States, UK - United Kingdom

*Interpreted by author (Kearney, A. T. FDI Confidence Index Flash Survey, 1998, 1999, 2001, 2005, 2007, 2010)*

The Czech Republic started in 1998 sixteenth position and was appeared among the countries experiencing the greatest increase in new investment interest as a Brazil, Mexico, Poland and Hungary. The best position was achieved in 2005 - on twelfth position but in 2007 fall on the 25<sup>th</sup> rank a last year (2010) was situated on 17<sup>th</sup> position.

## 4. The investment incentives brings foreign direct investment (FDI)

CzechInvest is the investment and business development agency of the Czech Republic whose contribute services and development programs of the Ministry of Industry and Trade to attracting foreign investment and to developing Czech companies. The CzechInvest is exclusively authorized to file applications for investment incentives at the competent governing bodies and prepares draft offers to grant investment incentives. Its task is also to provide potential investors current data and information on business climate, investment environment and investment opportunities in the Czech Republic.

### 4.1 The biggest investors to the Czech industry

Investors - both foreign and Czech - have the possibility to obtain investment incentives whose purpose is to support the introduction or expansion of production (General Information on the System of Investment Incentives in the Czech Republic, 2010).

Table no. 2: The biggest investment in the Czech Republic 1993-2009 (minimal 1000 jobs)

Rank	Investor	Sector	Country	Capital mill. CZK	Jobs	Year
1)	AVX	electronic	United Kingdom	1860	1 100	1998
2)	Hon Hai Precision Industry	electronic	Thai-wan	2 840	1 930	2000
3)	L.G. Philips Displays Holding	electronic	Netherlands	7 220	3 250	2000
4)	Matsushita Electric Industrial Co.	electronic	Japan	2 602	1 440	2000
5)	Matsushita Electric Industrial Co.	electronic	Japan	8 425	1 182	2000
6)	Nemak	automotive	Mexico	11 361	1 361	2000
7)	Robert Bosch	automotive	Germany	8 507	1 485	2000
8)	Tyco	electrotechnic	US	1 271	1 200	2000
9)	FIC	electronic	Thai-wan	523	1 300	2001
10)	Siemens VDO Automotive	automotive	Germany	6 271	1 900	2002
11)	Black & Decker	manufacture	US/UK	1 541	1 300	2002
12)	Eaton	automotive	US	1 695	1 182	2002
13)	Toyota/PSA	automotive	Japan/France	29 787	3 000	2002
14)	Infosys Technologies	other	India	102	1 000	2004
15)	Kiekert	manufacture	Germany	797	1 130	2004
16)	Volkswagen	automotive	Germany	6 121	2 150	2004
17)	Asus TeK Computer	electronic	Thai-wan	648	1 300	2004
18)	FAURECIA	automotive	France	2 119	1056	2005
19)	Hyundai Motor Company	automotive	South Korea	30 000	3 000	2006
20)	IPS Alpha Technology	electronic	Japan	2 958	2100	2006
21)	Hitachi	electronic	Japan	2 500	2000	2006
22)	Foxconn Technology CZ s.r.o.	electronic	Netherlands	2 676	6 400	2007

Interpreted by author (Udělené investiční pobídky 1993 – březen 2009.,2010)

The biggest capital investment was in case Toyota/PSA, near the 30 000 CZE. The similar capital assets are fabrication of automotive Hyundai Motor Company. Next investment giant is Nemak, Mexican automotive company specializes in the production of aluminum cylinder heads, engine blocks and transmission parts. The first position of newly creative jobs had L. G. Philips Displays Holding, but only on paper (*Vyhodnocení investičních pobídek ve zpracovatelském průmyslu, 2010*)<sup>3</sup>.

Agency CzechInvest supported investment activities from 1993 to August 2009 more than 800 projects, capital volume was near 600 billion CZK (18 000 mil. €), 150 000 newly created jobs<sup>4</sup>. This list contains promised investment and planed newly created jobs without later correction. In case L. G. Philips Displays Holding has never employed 3 250 workers, maximum was 1 600 employees (*Vyhodnocení investičních pobídek ve zpracovatelském průmyslu, 2010*).

## 5. The short analysis influence of investment incentives

It is possible to evaluate influence investment incentives on economy, region development, and region unemployment.

Next criteria's could analyze of investment projects in full details:

- new created jobs
- investment
- sector
- region

Main target of the investment incentives should be increasing employment in regions with high rate of unemployment. There are the results in Table no. 3: The percentage share of investment and jobs according the region. It shows the highest investment in region of Central Bohemia and the worst effectiveness of supported projects then in other regions. It can be assuming that amount of incentives was lower in Central Bohemia than in North Bohemia and Moravia- Silesia.

Table no. 3: The percentage share of investment and jobs according the region

Rank	Investment	Jobs	Region
1)	20 %	14%	Central Bohemia
2)	17 %	14 %	North Bohemia
3)	15 %	13 %	Moravia- Silesia
4)	7 %	12 %	South Moravia

Interpreted by author (*Vyhodnocení investičních pobídek ve zpracovatelském průmyslu, 2010*)

Table no. 4 *The percentage share of investment and sector in the Czech Republic 1998-2008* shows the superiority of automotive industry. The sum of automotive trade and engineering is 52 %, this is majority share of total investment. The share both trade on new

<sup>3</sup> Evaluation of investment incentives in the manufacturing industry

<sup>4</sup> Including all projects, not only investment incentives

created jobs is only 43 %, it means that effectiveness of the investment incentives is lower. The highest effectiveness brings the sector of information technology (IT) and call centers. Both of this trades share of investment 1% and bring share 5 % of new created jobs. These trades have high added value and aren't so energy-intensive.

Table no.4: The percentage share of investment and sector in the Czech Republic 1998-2008

Rank	Capital mill. CZK	%	Jobs	%	Sector
1)	252 208	45	56 332	35	Automotive industry*
2)	64 665	12	35 631	22	Electronic and electrical industry
3)	65 673	12	10 095	6	Chemical, rubber and plastic industry
4)	41 091	7	13 615	8	Engineering, manufacturing
5)	28 983	5	3 743	2	wood-processing, paper industry
6)	9 222	2	6 635	4	Repair business and technology centers
7)	7 734	1	7 694	5	Information technology (IT)
8)	5 164	1	8 465	5	Call center
9)	7 819	1	1 254	1	Pharmaceutical industry
10)	3 180	1	950	1	Aircraft industry
11)	75 371	13	17 543	11	Other
<b>Total</b>	<b>561 109</b>	<b>100</b>	<b>161 957</b>	<b>100</b>	

\* There are sum of automotive and manufacture sectors - 7% from the total investment capital.  
*Interpreted by author (Vyhodnocení investičních pobídek ve zpracovatelském průmyslu, 2010)*

The largest influx of projects in number and amount of planned investment in 2006, when the value of planned investments represented approximately 90 billion CZK. It reflected the best ranking the Czech Republic in 2005 in the FDI Confidence Index –twelfth<sup>hs</sup> position. The highest expenditure of government was in 2007, more than 6 billion CZK (Table no. 5: The Investment incentives in the Czech Republic and fiscal income). Worst ranking was in 2007 – 25<sup>th</sup> position - and interest foreign investors about investment in the Czech Republic was lowest in last five years.

Table no. 5: The Investment incentives in the Czech republic and fiscal income

Year	Fiscal income (mil. CZK)	Investment Incentives (mil. ZK)
1998	1 793 006	16,630
1999	2 884 317	99,864
2000	5 213 101	400,634
2001	10 683 631	948,806
2002	16 662 239	2,363,728
2003	20 041 551	3,122,017
2004	23 258 152	5,084,665
2005	31 133 265	3,524,027
2006	41 650 797	4,418,130
2007	51 119 745	6,043,638
2008	55 147 712	4,046,685
Sum	259 587 516	30 068 822

## 6. Summary

The Czech Republic despite of small area is attractive for foreign investors. The main reason to invest in the Czech Republic is location, skilled workforce, high share of secondary and tertiary education within population and of course the system of investment incentives. The subsidies were granted especially to investors of manufacturing industry until quite recently the priorities can be changed. The priority must be given to projects in the area of services, business support services, movie industry, biomedical and pharmaceutical industries, nanotechnology or research/development centers. These sectors can increase effectiveness of grants and can rise the competitiveness all country.

## References

- [1] KIROVOVÁ, I. *Kariéra v souvislosti s přechodem k postindustrialismu*. VŠB-TU Ostrava. 2007.
- [2] Incentives. UNCTAD *Series on Issues in International Investment Agreement*. United Nations. New York and Geneva 2004. [on-line]. Available at: <[http://www.unctad.org/en/docs/iteit20035\\_en.pdf](http://www.unctad.org/en/docs/iteit20035_en.pdf)> [Accessed on 20 August 2011].
- [3] JAHN, M.: *Investiční pobídky – nezbytný efektivní nástroj ke zvýšení přílivu a zlepšení struktury přímých zahraničních investic*. [on-line]. Available at: <<http://cepin.cz/cze/predonska.php?ID=229>> [Accessed on 5 August 2011].
- [4] FDI Confidence Index Flash Survey, 2001. [on-line]. Available at: <<http://www.oecd.org/dataoecd/54/62/2408143.pdf>> [Accessed on 2 August 2011].
- [5] The 2005 FDI Confidence Index Flash Survey, 2005. [on-line]. Available at: <<http://www.atkearney.com/main.taf?p=5,3,1,140,14>> [Accessed on 12 August 2011].
- [6] FDI Confidence Index. 2002 [on-line]. Available at: <[http://www.atkearney.de/content/misc/wrapper.php/onme/file\\_fdi\\_confidence\\_index\\_2002\\_10679757661877.pdf](http://www.atkearney.de/content/misc/wrapper.php/onme/file_fdi_confidence_index_2002_10679757661877.pdf)> (2002) > [Accessed on 2 August 2010].
- [7] Kearney, A.T. *FDI Confidence Index 2005*. 2005 [on-line]. Available at: <[http://ees.net.nz/info/FDICI\\_2005\\_Press\\_slides.pdf](http://ees.net.nz/info/FDICI_2005_Press_slides.pdf)> [Accessed on 8 August 2010].
- [8] New Concerns in an Uncertain World. [on-line]. Available at: <<http://www.gtai.com/homepage/...eng/.../fdi-confidence-index-2007/>> [Accessed on 20 August 2011].
- [9] Investiční pobídky v ČR. 2005 [on-line]. Available at <[http://www.mfcr.cz/cps/rde/xchg/mfcr/hs.xsl/ochrana\\_investic\\_12135.html?vd=1](http://www.mfcr.cz/cps/rde/xchg/mfcr/hs.xsl/ochrana_investic_12135.html?vd=1)> [Accessed on 5 June 2011].
- [10] General Information on the System of Investment Incentives in the Czech Republic. [on-line]. Available at: <<http://www.mpo.cz/dokument12478.html>>.[Accessed on 14 August 2010].
- [11] Udělené investiční pobídky 1993 – březen 2009. [on-line]. Available at: <<http://www.czechinvest.org/data/files/udulene-investicni-pobidky-60-cz.xls>> [Accessed on 20 January 2010].

- [12] Odbor podnikání: *Vyhodnocení investičních pobídek ve zpracovatelském průmyslu*. [on-line]. Available at: <[http://www.mpo.cz/zprava\\_31147.html](http://www.mpo.cz/zprava_31147.html)> [Accessed on 2 July 2010].
- [13] *Kam investoři nejraději směřují své finance?* [on-line]. Available at: <<http://www.mesec.cz/clanky/kam-investori-nejradeji-smeruji-sve-fionnce/>> [Accessed on 11 October 2010].
- [14] Agentura pro podporu podnikání CzechInvest, *Finální zpráva vyhodnocení dopadů investic čerpajících pobídky a zhodnocení efektivity agentury CzechInvest*, 2010. [on-line]. Available at: <<http://www.czechinvest.org/data/files/analyza-dopadu-pobidek-na-cr-2050-cz.pdf>> [Accessed on 31 August 2011].

## Summary

Investiční pobídky jsou častým politickým nástrojem, který slouží k přilákání přímých zahraničních investic (PZI). Nejčtenější jsou pobídky finanční a daňové. Režim pobídek je často používán místo nízkých daňových sazeb, protože tak mohou být podporovány formou přímé hospodářské politiky konkrétní prioritní hospodářské činnosti. Česká republika se také snaží přilákat domácí a zejména zahraniční investory. Popularitu jí přináší hodnocení Index důvěry PZI. Zájem investorů je formován různými informačními zdroji.

[15]