

JANINA WITKOWSKA

**Policies with Respect to Foreign Investors in the New Member States
of the European Union and in the Developing Countries of Asia:
A Comparative Aspects**

Abstract

The purpose of this article is to provide a comparative analysis of policies aimed at foreign investors in the new member states of the European Union as well as in the developing countries of Asia. The policies demonstrate certain similarities in spite of the fact that the analyzed world economic regions are subject to different conditions. A common feature is the opening up of economies to foreign investors, coupled with the application of certain incentives intended to increase the attractiveness of the country to foreign investors. Countries strive to modernize their economies with the help of foreign capital. The developing countries of Asia, in contrast to the new member states of the European Union, are not restricted in their policies with respect to foreign investors by the requirements of regional economic integration.

1. Introduction

The flow of foreign direct investment (FDI) between countries is governed by legal regulations assumed independently by individual countries or stemming from international agreements—bilateral and multilateral. These regulations usually apply to matters of significance to foreign investors—i.e. the defining of guaranties of rights in the host country as well as restrictions on operations, and the defining of legal forms for ventures undertaken in the host country. In the case of foreign investors, of prime importance are legal guaranties relating to the transfer of capital and its re-transfer in the event of the

liquidation of the company, indemnity in the event of expropriation, and the transfer of profits to the mother country. In terms of the profitability of operations in the host country, it is the scope of openness of the economy to foreign investment projects by sector, industry, and region that is of importance—i.e. the accessibility of sectors, industries, and regions to foreign investment, required permits and licenses, and tax rates.

Regulations with respect to foreign investors, as well as to policies aimed at foreign investors in the broad sense, are subject to change over the long term. This is influenced by processes of globalization, membership in organizations regulating trade and the flow of capital on an international scale, and processes of regional integration. The result of the action of the factors includes changes in what is known as the investment climate, moving towards a liberalization of conditions for operation by foreign investors.

The objective of this article is:

- A comparative analysis of policies aimed at foreign investors in the new member states of the European Union (EU) and in the developing countries of Asia,
- The identification of similarities and differences in the policies of countries belonging to the two regions of the world's economy, and
- The identification of factors determining changes in approach to foreign direct investment.

2. Policy Models with Respect to Foreign Investors

Policy models targeted at foreign investors fill a broad gamut ranging from negation of any positive impact of foreign capital on the host country and strict control over its flow all the way to a completely liberal approach to the involvement of foreign capital in the development of the host country.

Among country accepting foreign direct investment, what can be seen is the clashing of two approaches to constructing foreign investor policy. On the one hand, there is the **traditional policy of strengthening location advantage by offering incentives**, sometimes extremely developed incentives. Examples of fiscal incentives usually include reduced tax rates on corporate entities, tax vacations, tax refunds in the event of profit reinvestment, accelerated depreciation, import duty exemptions and tax reimbursements, specific tax base deductions, and decreased social security burdens. The primary purpose is to decrease the tax burden encumbering foreign investors, thus decreasing the costs of conducting operations in the given host country. Financial incentives

encompass grants and subsidies offered to investors (UNCTAD 1996, J. Witkowska 2007). What is known as the prisoner's dilemma makes its appearance in the case of incentives. The use of incentives by other countries forces their application in the given country in spite of the hazard of unfavorable effects such as the loss of state budget revenues and the potential for attracting "inappropriate" investments, primarily targeted at procuring financial support.

On the other hand, an awareness is growing that the attracting of foreign investors strengthens a country's economic "foundations," understood as the development and modernization of infrastructure, increased supply of trained workers resulting from a proper educational policy, the achievement of economic and political stability, and long-term improvements in perspectives for economic growth (C. Oman 2000). For their part, investors select the location for investment as a part of a decision process that has at least two stages. In the first phase, they build a shortlist of potential investment locations that are acceptable in terms of basic economic characteristics and the political "foundations" of the given country, understood as above. Essentially, the accessibility of financial and fiscal incentives in the potential host countries is not taken into account at this stage. It is in the second phase that investors consider the incentives offered by the host countries. They even go so far as to try to play off the efforts of individual countries striving to attract foreign investments in their favor.

Familiarity with the decision-making process in companies undertaking direct investment abroad, especially transnational corporations, makes it obvious that they compare investment conditions occurring in diverse and even mutually distant regions. This justifies the comparative approach and the effort to compare policies between two world economic regions that are subject to different conditions—the countries of Central and Eastern Europe, the new member states of the European Union, and the developing countries of Asia.

3. Policies Aimed at Foreign Investors in the New Member States of the European Union

The new member states of the European Union have adapted their policies aimed at foreign investors to the changed conditions under which they are now functioning. These conditions are defined by European Union regulations relating to the uniform internal market. It is within this framework that the principle of free flow of capital is in effect, which signifies an interdiction against any restrictions relating to the flow of capital, including foreign direct investments. At the same time, these regulations do not preclude the possibility

of influencing domestic and foreign investment, assuming that national treatment and European Union governing public assistance are observed.

An example of changes in policy with respect to foreign investors in the new member states demonstrates that the primary change in the philosophy behind the policies occurred during the period of systemic transformation. In the first half of the nineteen–nineties it was an autonomous policy unaffected by any international obligations. It was then that the analyzed countries offered foreign investors basic guaranties relating to respect for ownership (protection against expropriation or appropriate compensation in necessary cases), and the potential for the transfer of profits abroad and the re–transfer of capital. These countries also offered foreign investors various tax privileges that were not always available to local companies. At the same time, restrictions on access to certain branches of the economy, the need to procure permits, and screening requirements were maintained. Subsequently, these policies underwent a deregulatory phase with the implementation of national treatment, which meant the repeal of existing restrictions on foreign investors and the guarantying them of the same treatment as domestic investors. During the pre–membership period, these countries offered investors, including foreign investors, numerous incentives of financial and fiscal character. Following entry into the European Union, they adapted the offered investment incentive models to rules governing state assistance in force in the European Union. Today, prerequisite to the utilization of incentives is the creation and maintenance of jobs, employee training, and investment in poorly developed regions, for example (J. Witkowska 2007).

In connection with the major weight assigned by the European Union in the development of a knowledge–based economy, which finds its expression in the Lisbon Strategy, the member states apply various instruments supporting key elements of such a knowledge–based economy—i.e. research and development work, innovational activities, modernization of machines and equipment serving communications and facilitating the flow of information, acceleration of the replacement of computer hardware and software, and the raising of workforce qualifications through training (J. Witkowska 2008b).

Incentives for modernizing the economy are addressed to all entities meeting requirements as defined by regulations. However, it may be assumed that pursuant to detailed terms of receiving support, the primary addressees are foreign investors. Support for investments aimed at modernizing the economy is conducted through traditional instruments such as financial incentives (grants and subsidies) and fiscal ones. Moreover, specific instruments such as technology parks, industrial parks, and high–technology and business incubators are applied.

The new member states benefit from European Union Structural Funds, designating them for programs supporting innovation and the creation of human capital. These resources are equally accessible by foreign entities.

4. Policies Aimed at Foreign Investors in the Developing Countries of Asia

Historically, the policies of the developing countries of Asia with respect to foreign investors were varied. The approach to foreign capital was dependent on the place and role it was assigned in the country's development strategy. Several policy models relating to foreign investors as used in Asia may be identified (UNCTAD, 1999).

- A passive “open door” policy for both FDI and trade that is free of intervention in selectively promoted industrial development (e.g. Hong Kong /China and China),
- Active industrial policy and promotion of local companies in certain spheres of economic activity, with a simultaneous efficient and non-interventionist “open door” policy with respect to foreign capital in most export-oriented industries (e.g. Malaysia and Thailand),
- Active intervention in promoting strong involvement by transnational corporations in the country's processing industry, no discriminatory treatment of foreign investors to the benefit of local industry, and selective encouragement of foreign investors to increase the level of their potential, including through strengthening local technological potential (e.g. Singapore), and
- Restrictions on FDI and a dependence on “externalized”¹ forms of technology transfer, the conducting of a developed industrial policy targeted at strengthening the local processing industry sector, the promotion of local ties among economic entities, and growth in national innovation potential (e.g. the Republic of Korea, Taiwan, and even earlier, Japan).

Today, policies with respect to foreign investors in the Asia region have a common quality. They are becoming increasingly liberal and friendlier towards foreign investors. Changes in national policies aimed at foreign

¹ “Externalized” technology transfer involves providing access to technology to other, autonomous entities on the basis of agreements. Such “externalized” transfer of technology takes on various forms—i.e. joint ventures, franchising, sale of capital goods, licenses, technical assistance, subcontracting, and proprietary equipment manufacturing agreements.

investors are continuously taking place in Asia. They are mostly deemed to be favorable for the investor. According to UNCTAD, nine countries introduced thirteen changes in investor policy in 2007. Of these, ten were considered favorable for investors. Some governments eased restrictions on investors in the realm of ownership (UNCTAD 2008).

For example, the government of **India** increased the allowable upper limit of the share held by foreign capital in telecommunications up to 74%, from the previous limit of 49%. Starting with 2008, liberalized regulations also encompassed other industries and services in India, such as civil aviation, refineries, and certain branches of the mining industry, construction, industrial parks, and commerce.

Vietnam adopted new regulations in May of 2007 that permitted foreign and local investors to take part in infrastructural investments by concluding agreements for the construction, management, and exploitation of completed projects (BOTs – build, operate, and transfer) as well as other similar agreements. As a result of Vietnam's entry into the WTO on January 1, 2007, the government of that country took on obligations to open various branches of industry to foreign investors or to ease existing restrictions.

The countries of Asia undertook various actions aimed at **facilitating investor activities** in this region. An example of such efforts is the increased level of legal protection for investments (**Indonesia**), and greater legibility in criteria applied in screening takeovers of local companies by foreign investors with respect to national security risk (the **Republic of Korea**).

The countries of Asia have introduced various **incentives** with respect to foreign investors: **Malaysia** and **India** – fiscal incentive, and the **Republic of Korea**, **Thailand**, and **China** – other investment incentives. Incentives are aimed at attracting new investment to major branches of industry of the host countries.

At the same time, the analyzed region has introduced regulations into its policies with respect to foreign investors that limit investor access to certain branches of the economy—branches where the government wishes to maintain control. Sector orientation of investments is also being tried.

A more detailed analysis of policies aimed at foreign investors conducted on three countries of this region—i.e. **China**, **Korea**, and **India**—demonstrates that policy evolves towards the creation of more favorable conditions for investor activities. However, these states are not surrendering influence over the decisions of investors with respect to the industry and geographical structure of investment in their economies.

5. Chinese Policy with Respect to Foreign Investors

The policy of China with respect to foreign investors changed over the nineteen–nineties towards an easing of applied restrictions. These changes facilitated the functioning of foreign investors, especially as observed as of the year 2001—i.e. following China’s entry into the WTO. The most important changes encompass (<http://www.worldwide-tax.com> and <http://www.china-briefing.com>):

- Allowing the establishing of branches of foreign companies within the Chinese economy where 100% of shares belong to foreign capital, though there are exceptions to this rule,
- Permission to sell goods and services on the domestic market, and
- Allowing foreign capital into economic fields other than industry and hi–tech, such as banking, insurance, financial services, etc.

The scope of opening of the Chinese economy to foreign capital remains varied and depends on economic sector. Initially, policies aimed at investors were targeted at an intense attracting of investors, mainly to industrial processing. The Chinese government provided a rich set of incentives for foreign investors investing in priority industries and locations. Currently, the Chinese government is stressing that it is interested in the quality of foreign investments, not quantity. Moreover, strategic branches of the economy over which the government wishes to maintain control have been defined. They are (1) telecommunications, (2) the petrochemical industry, (3) defense, (4) energy, (5) coal mining, (6) civil aviation, and (7) maritime shipping. Takeovers with the participation of foreign companies are subject to special regulations and screening in terms of relevant anti–trust and economic national security regulations.

Up to the significant changes in the tax system introduced as of January 1, 2008, **fiscal incentives** were the chief instrument of Chinese policy with respect to foreign investors. No financial incentives in the form of grants were offered, however. This was in agreement with certain regularities observed in the world economy, where developing countries prefer to apply fiscal incentive to increase the attractiveness of their countries (UNCTAD 1996).

In China, the system of fiscal incentives encompassed four basic elements, specifically (J. Li and A. Paisey 2005):

- **Tax rates** on the income of foreign companies located in Special Economic Zones amounted to **15%**, while the rate in the economic zones opened on the coast was **24%**,
- **Tax vacations** covering the first two years of profit-generating operations and the lowering of the tax rate by 50% over the three subsequent years for companies in business for at least ten years (the “2+3” rule),
- **Tax allowances by virtue of the re-investment of profits** encompassed the reimbursement to the foreign investor of income tax if his profits were reinvested, where the reimbursement generally encompassed 40% of the tax paid by the foreign company and where a 100% refund was possible in the case of profit reinvestment in high-technology or export-oriented companies, and
- A **complete exemption** on tax on dividends.

These privileges, acquired by investors conducting activity in China will continue to be respected over a five-year transitional period.

New tax regulations bring in significant changes. Foreign and domestic companies are made equal in terms of taxation. In the prior system, domestic companies were obliged to pay a 33% income tax, which signified their less favorable treatment as compared with foreign companies. The tax system also created worse conditions for domestic companies in foreign relations.

Changes in the tax system introduced on January 1, 2008 are regulated by a single legal act that applies to both foreign and domestic companies. Key elements in the new tax system are as follows (M. Petriccione and W. Zhang 2007):

- The **tax rate** on company income amounts to 24%,
- **Fiscal stimuli** in effect to date **have been eliminated** (where foreign investors maintain their acquired privileges throughout a five-year transition period),
- The tax allowance for profit re-investment **has been withdrawn**,
- A **reduced tax rate of 15%** has been introduced for **companies in the hi-tech field and 20% for small companies**,
- The tax exemption on dividends for foreign investors **has been eliminated**, where general regulations ordering a 20% rate are to be applied (regulations allow the government to lower this tax rate, where a reduction to 10% is expected, though not to zero),
- The **principle of “narrow capitalization”** is in force, whereby the percentage of a connected (dependent) debt of a partner cannot exceed the proportion as defined with respect to his share in the assets,

- For tax purposes, the **concept of “resident” has been expanded** to foreign companies with corporate entity status that are actually managed in China,
- A uniform tax allowance in the form of **credit** for tax due on branches located abroad has been introduced,
- The **principle of a controlled foreign company** has been introduced, which assumes that if a foreign company controlled by a Chinese resident is established within the area of a jurisdiction with an effective tax rate that is “decidedly lower” than 25%, the share of profits of the foreign company due to Chinese resident shall be subject to immediate taxation in China, unless there is a “business justified reason” to keep the profits abroad, and
- There is also a general regulation applying to tax evasion, which refuses any right to tax benefits from any transactions that does not have “justified business objectives.”

The changes described above signify that China is no longer a jurisdiction of low taxes for foreign investors. The long-term consequences of the new regulations, disclosed in changes in the behavior of foreign investors, will be subject to assessment over the upcoming years. No decrease in the flow of FDI into the Chinese economy was observed immediately following the introduction of the new regulations. This was determined by the strong aspects of the Chinese economy (WTO membership, stability, good processed merchandise export conditions, a growing consumption-oriented middle class, and incentives for hi-tech businesses).

The new tax system clearly points to a shift taking place in Chinese policy with respect to foreign investors—i.e. from a policy based on the application of a wealth of instruments to attract foreign investors to a more neutral policy that assumes the equal treatment of foreign and domestic companies. The new regulations create favorable tax conditions for the expansion of Chinese companies abroad.

Subject to conditions of a global financial crisis, China is not surrendering use of tax instruments to **stimulate export**, whose rate of growth has started to slow in the fourth quarter of 2008. The Chinese government has accepted the coming into force of a second packet of tax stimuli with respect to goods exported from China. A total of 3,770 products were encompassed by the return of VAT on goods used in the production of export merchandise as of December 1, 2008, which involves 27.9% of all products exported out of China. Tax refunds primarily involve labor-intensive goods, machines and electrical products, and other products whose export figures showed the greatest fall. The previous packet, which came into effect on November 1, 2008, encompassed 3,485 products (China to Boost Export Tax Incentives as It Battles Crisis, <http://ca.news.yahoo.com>).

6. Korean Republic Policy with Respect to Foreign Investors

Two contradictory tendencies have been clashing for years in the policy of the Republic of Korea with respect to foreign investors. They may be described as the “attraction and aversion dilemma” (W. Stoever 2002). On the one hand, the country wanted to achieve benefits by virtue of the activeness of foreign investors in the economy (technology, know-how, and skills). On the other hand, it was intent on limiting the “encroaching” of foreign entities and their competition on the domestic market. This was witnessed by the application of policy instruments that supplemented the action of market mechanisms and allowed for the shaping of desirable characteristics among foreign direct investment inflow. This was served by a system of screening, permits, incentives, regulations, and administrative means used to monitor and control the flow of investment and to direct it to the desired branches of industry. The expanded system of regulation was supplemented by investment incentives. Policies with respect to foreign investors had a selective character.

The opening up of the Republic of Korea to the inflow of FDI occurred under the influence of its strengthening economic position and external pressure (OECD membership). However, the Korean government did not surrender its influence over the inflow of FDI and its character by way of a system of **fiscal and financial incentives**. The passage from a philosophy of “control and regulate” to one of “promote and support” occurred at the end of the nineteen-nineties in the wake of the financial crisis of Southeast Asia.

Currently, the Korean government is offering foreign investors certain privileges, incentives, and guaranties within the framework of the Foreign Investment Promotion Act (FDI Incentive, <http://www.investkorea.org>, Asia Pacific Tax Notes, Korea, PricewaterhouseCoopers, 2008, A Summary, Samil, PricewaterhouseCoopers, Seoul, 2008). These include:

- **Company income tax exemptions for companies** with the participation of foreign capital that are involved in the advancement of hi-tech activities, which can receive a 100% tax exemption for five years, starting with the first year when they achieve a profit and a 50% tax break for the next two years, where it is also possible to receive exemptions from local taxes in line with the same principles,
- **Fiscal incentives and benefits for foreign investors** meeting defined requirements that are offered in designated areas and available exclusively to foreign investors, including in foreign investment zones (FIZ), free

economic zones (FEZ), free trade zones (FTZ), and strategic industrial complexes,

- **The fiscal incentives in the foreign investment zones (FIZ)** are similar to the incentives available for foreign companies conducting hi-tech operations—i.e. a five-year tax exemption starting with the first year of profitability, a 50% tax break for a successive two years, as well as a five-year exemption on takeover, real estate, and registration tax, a three-year exemption on customs duties on imported capital goods—where changes introduced by the new tax regulations of 2008 are moving towards an easing of criteria to date in providing benefits for foreign investors in foreign investment zones, where one change allows benefits in the form of privileges offered in foreign investment zones in investments in hotels and the tourist-recreational industry (with a minimum capital input of USD 20 million), and where a second change involves the reducing of the minimum requirements as to the level of invested capital on new or existing research and development work from the previously required USD 5 million to USD 2 million,
- **Fiscal incentives in the free economic zones, free trade zones, and strategic industrial complexes** involve a 100% tax exemption for a period of three years starting with the first year of profitability, followed by a 50% tax break for the next two years, where it is additionally possible to receive exemptions on local taxes in line with the same principles, where investors in this zones and the complexes are guaranteed an exemption on the tax on dividends,
- **Tax exemptions for a period of five years** on royalties within the framework of special contracts for stimulating the introduction of high technology,
- **Fiscal incentives for stimulating export** (a zero VAT rate on exported goods and a refunding of customs duty on imported raw materials used in the manufacture of export goods), and
- **Financial incentives (grants)** have been offered by the Korean government as of the year 2004, where it is necessary to meet defined requirements relating to investment volume, business type, and character of the foreign ownership, where pursuant to modifications introduced by way of regulations in 2008, such grants are additionally offered when (i) it is a regional corporate transnational headquarters being established that controls activities in at least two out of three or more host countries, (ii) investments are made by foreign non-profit organizations in order to build a new or additional research and development center, where no less than ten full-time technical personnel must be employed, and (iii) additional

investments are made in regional strategic industries deemed as playing a role in regional economic growth.

7. Indian Policy with Respect to Foreign Investors

Indian policy with respect to foreign investors is subject to a process of liberalization starting as of 1991. Compared with the previously conducted policy, the present is more lucid and liberal. Foreign investors have been granted basic guaranties and legal security encompassing investment capital and the re-transfer of profits. However, this does not mean that investors have received completely free access to the Indian economy. This access is, to a great extent, governed by regulations defining permit procedures, the level of openness of individual branches, exclusions in access to certain fields, requirements for the receiving of industrial licenses, and site restrictions. At the same time, India offers foreign investors developed, albeit selective fiscal incentives (Doing Business in India, <http://www.indianembassy.org>).

As a result of the liberalization in approach to foreign investment, India allows the possibility of investing in all fields of the economy, with the exception of **sectors excluded from foreign direct investment**. These are (1) lotteries and gambling, (2) retail trading (with the exception of trading in a single brand), (3) nuclear energy, (4) agriculture (with certain exceptions such as growing flowers, gardening, seed growing, etc.), and (5) plantations (with the exception of tea plantations).

As to the remaining branches of the economy, **two procedures** are applied in the **issuing of permits**: (i) an automatic procedure that does not necessitate the procurement of prior permits, and (ii) permits issued by the government through the offices of the Foreign Investment Promotion Council.

Starting with the year 2000 it is possible for an investor to hold a 100% share in new and already existing companies by way of the automatic procedure. Exceptions from this rule are:

- Activities requiring industrial licenses,
- Proposals when the foreign partner has ventures/ties in India in the same field,
- The takeover of shares in the financial sector that are held by a domestic shareholder, and
- Proposals that do not fit in with the notified sector policy.

If the project does not qualify for the automatic procedure, decisions are taken on an individual basis by the Foreign Investment Promotion Council, in line with detailed principles assumed in the sector policy.

Licenses are required for:

- i. Two areas reserved for the public sector—i.e. nuclear energy and the railways,
- ii. Five industries, where industrial licenses are obligatory (hazardous chemicals, explosives, alcohol production, space equipment and weapons, and tobacco products),
- iii. The manufacture of goods reserved for the small business sector (the list encompasses thirty–five products), and
- iv. Projects that are subject to local restrictions.

An overview of the **sector policy** shows that in spite of ongoing liberalization, there are still many sectors considered sensitive, where access by foreign investors is limited to certain share levels.

In addition to the above regulations, there are also **requirements relating to project location**. Industrial permits are required for investment projects that are to be located in cities with more than one million inhabitants (status as of 1991). Projects involving industries that pollute the environment may be located twenty–five kilometers from the peripheries of such cities or in previously defined industrial areas that respect local regulations relating to environmental protection.

It is within these regulatory frames that the Indian government creates **fiscal incentives for foreign investors**, although tax regulations usually apply higher taxes on foreign companies. The most important incentives are offered within the framework of the following institutions solutions:

- Entities that are 100% export oriented,
- Special economic zones,
- Technology parks targeted at software, and
- Industrial parks.

Entities that are 100% export oriented (export production zones) are units that operate in customs isolation and direct their entire production and the whole of their services for export, with the exception of allowable sales in what are known as national tariff areas. A foreign investor may have a 100% share in such an entity and is exempt from procuring industrial licenses on goods reserved for the small business sector. Available fiscal incentives include tax vacations on export profits guaranteed up to the year 2010. Such entities also

have guaranties of exemptions from indirect taxes and liberal currency regulations.

Special economic zones are areas excluded from India's customs area, where the government, by way of numerous conveniences, hopes to create conditions fostering the conducting of business. Entities located in the special economic zones can hold a 100% share in company ownership. They may produce goods or provide services and should be net exporters. However, no initial requirements as to export levels are formulated for them. The sale of their products on the domestic market is allowable, but it is subject to customs regulations in force. The basic stimulus for investing in these zones involves **fiscal incentives** earmarked for entities developing the zones (a 100% tax exemption for ten years) as well as for entities located in the zones (a five-year total exemption on tax on export profits and a 50% tax break for the successive five years on tax due). Moreover, there are tax allowances on indirect taxes for companies active in the zones as well as liberal currency regulations.

Currently there are forty special economic zones, while over 200 successive ones have filed notice and a yet further 600 are in various phases of the approval process. The government intends to transform the active export production zones into special economic zones.

Software-oriented technology parks are targeted at supporting the development and export of computer software from India. The foreign investor may hold a 100% ownership share without any permits. Incentives include a 100% exemption on tax on export profits up to the year 2010. Moreover, investors may take advantage of customs duty exemptions in the export of computer equipment and software. There are no requirements as to the volume of export or income in convertible currency, but they should achieve a state of greater revenues than expenditures in convertible currencies within five years. There are currently thirty-four technology parks in operation.

Industrial parks are established in order to strengthen the development of infrastructure for industry. Regulations modified in 2008 require the procurement of permits for the establishing of industrial parks and define detailed requirements with respect to developers. Both they and entities placing their production in the industrial park have the right to a 100% income tax exemption.

The analyzed three cases of policies with respect to foreign investors as conducted by Asian countries confirm that these countries are undergoing an evolution towards more liberal policies. All countries applied generous incentives, mainly fiscal, for foreign investors. China has introduced changes involving the liquidation of earlier incentives that were favorable to investors and has eliminated privileges for foreign investors as compared with domestic

ones. Their policies have become more favorable for potential Chinese investors abroad. The two other countries continue to conduct a selective policy with respect to foreign investors, utilizing their potential and creating better conditions for the conducting of business in the domestic economy. All countries have applied such solutions as special economic zones, where different business rules apply than is the case in the national economy.

8. The Importance of Regional Integration Groups and International Cooperation Agreements for Foreign Direct Investments: The Experiences of the New European Union Member States and the Developing Countries of Asia

The impact of international integration processes on the flow of capital in the form of foreign direct investment among integrating countries is discussed in literature and confirmed by statistical data (W. Molle, 1990, J. Pelkmans 1997, Z. Wysokińska and J. Witkowska 2002, UNCTAD 2008). The clearly positive influence of deepening integration processes on the intensity of FDI streams was observed in the long term in the case of the **“old” member states of the European Union**. This bears witness to the real tightening of economic ties among those countries taking place. The **new member states of the European Union** are also the recipients of FDI streams, but in 2007 they accounted for a mere 8% of the total FDI stream flowing from the EU “27” (UNCTAD 2008, and own calculations).

With the expansion of the European Union in 2004 to include ten new member states, and a successive two in 2007, there was a significant increase in the scale of FDI flow into those countries. In as much as the economies of the world and of the old member states of the European Union continued to feel the negative effects of worsening world trends in 2004, the new member states (with the exception of Malta) noted a growing influx of FDI into their economies. For most of the new member states, the FDI stream increased its flow by a factor of two and in some cases even three and four as compared with the preceding year (UNCTAD 2007, J. Witkowska 2008). Most of the countries not only made up for losses noted over the last year preceding membership in the European Union, but even the scale of the inflow of FDI exceeded the levels of earlier years—i.e. those better than the difficult year 2003.

Successive years—i.e. 2005–2007—brought growth in the total FDI streams flowing into the new member states in an absolute dimension, but their dynamics was not as high as in the year 2004 (own calculations on the basis of UNCTAD 2007 and 2008). Certain new European Union member states noted

a certain fall in FDI in 2007 and preliminary data for 2008 signals a further fall in these streams. This bears witness to the complexity of factors influencing decisions relating to investment in a given country or region. Advantages displayed in remaining in a highly advanced integrated group are not capable of balancing out the negative trends making their appearance subject to conditions of world crisis as well as those influencing a restricting of the scale of foreign direct investments in the world economy as a whole and in its specific regions. Thus, an increase in rivalry among various world economic regions may be expected.

The **Asia** region has seen attempts at closer economic and social cooperation striving to create regional integrated groups for a long time now. They take on the form of intra-regional agreements intended to establish free trade zones or promote mutual trade and cooperation. Some such agreements have as their objective the introduction of conveniences for intra-regional investments. Regional organizations created by these agreements form the institutional framework for real integration processes. An overview of their achievements demonstrates that most are at a preliminary stage of initiating such processes.

The most advanced integrating venture in the Asia region is **AFTA (ASEAN Free Trade Area)**, which was established by the developing countries of Southeast Asia as a result of the signing of an agreement in 1992.² Integration among the analyzed countries of Southern and Eastern Asia faces difficulties, which is borne out by the long transitional period as well as lists of exclusions and exceptions. However, in connection with the liberalizing obligations taken on by the ASEAN member states within the framework of the WTO, it was decided to accelerate the creation of the AFTA free trade zone. The ASEAN member states signed the Framework Agreement on the ASEAN Investment Area (AIA) in 1998. Its objective is the strengthening of the attractiveness of the member states for foreign investors and their competitiveness with respect to other potential host countries. The creation of such an investment area is planned for the year 2010 and it is by that time that investors from the ASEAN member states shall be guaranteed the application of the principle of national treatment. Investors from third party countries will not be treated in line with that principle until the year 2020. The approach of these countries to foreign direct investment has been changing over time. Currently, they are undertaking ventures aimed at not only attracting new investors from partner countries, but also from third

² The zone encompasses the following countries: Indonesia, Malaysia, the Philippines, Singapore, Thailand, Brunei, and Vietnam (1995), Laos (1997), Myanmar (1997), and Cambodia.

party countries (ASEAN Secretariat, <http://www.aseansec.org>, J. Witkowska 2008a).

The **South Asian Association for Regional Cooperation (SAARC)** was established in **South Asia** in 1985.³ Its member states concluded an agreement on preferential trade (SAPTA). It came into effect in 1995. Its purpose is to promote and maintain mutual trade and economic cooperation through the exchange of licenses. Negotiations on granting mutual licenses encompassed 5,000 products. The achieved level of integration was not significant, however. The applied rules on origin were too restrictive for most countries and were gradually eased. Trade conveniences were not significant. Only the least developed countries received trade preferences of greater significance, while trade among the large countries continued to be the subject of trade barriers (SAARC, <http://www.saarc-sec.org>).

SAPTA was considered the first step to creating a free trade zone—the **South Asian Free Trade Area (SAFTA)**. The coming into force in 2006 of agreements on the free trade zone launched a process for the gradual reduction of customs duties in mutual trade, planned as a ten-year process. Countries belonging to SAARC declare that also in their field of interest is the signing of an agreement on investment promotion and security.

The achievement of the objectives assumed within the SAFTA framework is no easy matter as what is being attempted is the integration of large, rapidly developing countries and countries belonging to the least developed nations of the world. The level of regional integration, measured by the volume of intra-regional trade, is assessed as low, significantly below the level achieved by the ASEAN countries. The bringing down of trade barriers was commenced by India, for example, which decreased average tariffs by twenty percentage points over eight years, but the small countries of the group continue to apply higher tariff barriers than the countries of the ASEAN +3. What is underway is a scientific discussion on the economic effects of a complete elimination of tariffs in the mutual trade of these countries (J. D. Rodrigues-Delgado 2003).

Bearing in mind the specifics of this group, it may be assumed that even major progress in the integration of the goods market will not bring about significant changes in the stream of capital flow in the form of FDI inside the group. However, it may create a positive climate for such investments.

The **South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA)**, signed in 1980, is an asymmetrical trade agreement

³ Afghanistan (2005), Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka.

where two highly-developed countries—Australia and New Zealand—offer customs-free and unlimited or licensed access to their markets essentially for all products from the developing countries of the Pacific (Country-Island Forum). The only exception is the importing of sugar to Australia. The agreement also contains provisions relating to general economic, commercial, and technical collaboration. Benefiting from free access to the markets of these two highly-developed countries necessitated the defining and respecting of rules of origin within the framework of SPARTECA. It is also within the framework of the SPARTECA agreement that special treatment is guaranteed for the smallest countries—the islands of the Pacific—where aid is also envisaged for them (SPARTECA, Forum Secretariat Booklet, SPARTECA, Forum Secretariat, 1996).

SPARTECA offers assistance in trade and development for the developing countries of Oceania. There is economic and political sense behind this. Oceania is the recipient of relatively small quantities of capital in the form of FDI. This is the result of their level of development, the size of their economies, and their peripheral locations. The implementation of an agreement on regional trade helps develop certain locational advantages for the least developed countries of the region and may therefore have a long-term positive impact on the volume of FDI flowing into those countries.

Asia-Pacific Economic Cooperation (APEC) is a forum of countries aimed at facilitating economic growth, cooperation, and trade and investment in the Asia and Pacific region. It currently has twenty-one member states from the Asia and Pacific region. These include the most highly developed countries, newly industrialized ones, and developing countries. It is an inter-governmental group acting on the basis of non-binding obligations, open dialogue, and equal respect for the views of all participants. It has a relatively loose, non-integrational character without any treaty-based obligations encumbering the parties. Decisions are taken on the basis of consensus and obligations are on a voluntary basis. APEC is striving to reduce customs tariffs and other trade barriers in the Asia and Pacific region, viewing free trade and investment as development factors. Its long-term goals (Bogart Goals 1994) are the achievement of free trade and investment among the industrialized countries of the Asia and Pacific region by 2010 and among the developing countries by 2020 (APEC <http://www.apec.org>).

According to various assessments, the APEC countries have witnessed significant liberalization in policy with respect to FDI, but there are still many impediments in this area (S. Urata, M. Ando, K. Ito 2007). These are barriers stemming from insufficient liberalization of legal regulations relating to FDI. Additionally, there are other difficulties, defined as difficulties in the operations

of direct foreign investors. These include lack of clarity in applying policies with respect to FDI, underdeveloped infrastructure, and excessive worker protection. The APEC Trade and Investment Committee applies a total of ten criteria in assessing the level of liberalization and conveniences in FDI activities and expects that countries will conduct overviews applying these criteria. They are (i) clarity, (ii) treatment in line with most favored rules, (iii) national treatment, (iv) repatriation and exchangeability, (v) personnel hiring and laying off, (vi) taxation, (vii) requirements as to the achievement by investors of certain economic volumes, (viii) capital export, (ix) investor behavior, (x) competition, and (xi) other measures. Data contained in Table No. 18 show the ranking of countries in terms of ease of doing business in the APEC countries and bear witness to the fact that liberalization and facilities for business in those countries are being conducted in an uneven manner. The dividing line clearly runs between the industrialized and developing countries. The first are ahead in the ranking, while in the second group the conducting of business comes up against various difficulties.

The above-discussed intra-regional initiatives are of long-term importance for the flow of foreign direct investments. They should be examined in the context of a gradual easing of mutual trade and investment exchange. The bringing down of impediments to trade may, with time, also accelerate the flow of capital in the form of FDI, as such investments usually do not appear when commercial turnover between countries does not achieve a certain minimal level.

9. Conclusion

1. The new member states of the European Union and the developing countries of Asia, although in differing economic, political, and institutional situations, demonstrate similarities in approach to foreign investors. A common quality is the opening up of economies to foreign investors and applying various incentives aimed at increasing the attractiveness of the country to foreign investors. Both the new member states of the European Union and the developing countries of Asia are striving to modernize their economies through the utilization of foreign capital and are applying instruments supporting the creation of a knowledge-based economy. The level of openness is lower in the case of the developing countries of Asia than the new member states of the European Union, however.
2. The opening up of the new member states of the European Union to international flows of capital in the form of FDI took place gradually and

was the result of systemic transformation (with the exception of Malta and Cyprus). Membership in the European Union brought the process of liberalization of the flow of capital to its final phase, signifying a lack of barriers to the flow of capital in relations with the remaining member states, as well as with respect to third party countries. The freedom left the member states of the European Union in molding policies with respect to foreign investors must fit within the overall framework defined by respect for the principle of national treatment and public assistance rules.

3. In the case of the developing countries of Asia, essentially the economic integration processes are in their preliminary phase and are not beyond the stage of free trade zones. This stage of integration does not force liberalization of capital flow among member states. Liberalization in approach to foreign investors is the result of the individual decisions of specific countries that are not restricted in their policies as is the case of the new member states of the European Union.
4. Intra-regional integrational initiatives or those pertaining to commercial cooperation such as ASEAN, SAARC, SPARTECA, and APEC will have long-term importance for the flow of foreign direct investments in the Asian region. They should be examined in the context of mutual commercial and investment exchange. The elimination of barriers to trade can, with time, also foster an acceleration in the flow of capital in the form of FDI as such investments usually do not develop when trade turnover between the countries fails to achieve a certain minimal level.
5. A more detailed analysis of policies with respect to foreign investors conducted for three developing Asian countries—i.e. **China**, **Korea**, and **India**—demonstrates that these countries do not surrender influence over investor decisions as to branch and geographical structure of investments in their economies. China introduced changes involving the liquidation of previous incentives that were beneficial for investors and eliminated the privileged position of foreign investors as compared with domestic investors. Its policies are becoming more favorable for Chinese investors abroad. **Korea** and **India** conduct selective policies with respect to foreign investors, utilizing their potential for the technological modernization of the country, support for export, and the creation of better conditions for the conducting of business in the domestic economy. All these countries utilize solutions such as special economic zones as well as technology and industrial parks, where rules in force are different than those in the domestic economy.

References

- APEC, <http://www.apec.org>
- „Asia Pacific Tax Notes, Korea, Korean Tax Law Changes for 2008”, PricewaterhouseCoopers
- China Foreign Investments Incentives, <http://www.worldwide-tax.com>
- China to Boost Export Tax Incentives as It Battles Crisis, <http://ca.news.yahoo.com>
- China’s New Tax Incentives, China Briefing News, <http://www.china-briefing.com>
- Doing Business in India, Embassy of India, Washington D.C., <http://www.indianembassy.org>
- The EU and South Asian Association for Regional Cooperation (SAARC), http://www.ec.europa.eu/external_relations
- FDI Incentives, Tax Support, <http://www.investkorea.org>
- Foreign Direct Investment Statistics, ASEAN Secretariat, <http://www.aseansec.org>
- Molle W. (1990), *The Economics of European Integration (Theory, Practice, Policy)*, Aldershot.
- Li J., Paisey A. (2005), *International Transfer Pricing in Asia Pacific: Perspectives on Trade between Australia, New Zealand and China*, Palgrave MacMillan, Basingstoke, New York
- Pelkmans J. (1997), *European Integration: Methods and Economic Analysis*, New York
- Petriccione M., Zhang W. (2007), „China’s New Tax and Its Implications”, *Taxadviser*, December
- Rodrigues–Delgado J. D. (2003), “SAFTA: Living in a World of Regional Trade Agreements”, IMF Working Paper WP/07/23
- SAARC, Secretariat, <http://www.saarc-sec.org>
- SPARTECA, Joint Australia New Zealand and Forum Secretariat Booklet
- SPARTECA, South Pacific Regional Trade and Economic Cooperation Agreement, A Reference Handbook for Forum Island Country Exports, Forum Secretariat, 1996
- Stoeber W., *Attempting to Resolve the Attraction–Aversion Dilemma: A Study of FDI Policy in the Republic of Korea*,” *Transnational Corporations*”, Vol. 11. No 1, 2002
- “A Summary of Korean Corporate and Individual Income Taxes 2008,” Samil PricewaterhouseCoopers, Seoul 2008
- “Survey of Best Practices in Investment Promotion,” U.N., New York and Geneva, 1997
- UNCTAD (1996), “Incentives and Foreign Direct Investment,” UNCTAD, New York and Geneva
- UNCTAD (1999), “Foreign Direct Investment and Development,” UNCTAD, New York and Geneva

UNCTAD (2007), "World Investment Report 2007," *Transnational Corporations, Extractive Industries and Development*, U.N., New York and Geneva

UNCTAD (2008), "World Investment Report 2008," *Transnational Corporations and Infrastructure Challenge*, U.N., New York and Geneva

Urata S., Ando M., Ito K. (2007), „*Survey on Investment Liberalization and Facilitation, Obstacles to FDI in the APEC Economies: A Study Based on the JMC Firm Survey*,” Japan Machinery Center for Trade and Investment, APEC Investment Experts Group, APEC Committee on Trade and Investment

Witkowska J. (2007), *Foreign Direct Investment in the Changing Business Environment of the European Union's New Member States*, 'Global Economy Journal', Vol. 7, Issue 4, <http://bepress.com/gej/vol7/iss4/2>

Witkowska J. (2008a), *Regional Integration and Capital Mobility in the World Economy: Experiences of the European Union, NAFTA and AFTA*, 'Comparative Economic Research', Vol. 11, 2008, No. 1/2

Witkowska J. (2008b), „The Role of Foreign Direct Investor Policies in Creating a Knowledge-Based Economy in the New Member States of the European Union,” *Innovation, Technology and Knowledge-Based Economy in the EU New Member States*, edited by J. Witkowska, Z. Wysokińska, Comparative Economic Research, Vol. 11, 2008, No. 3

Wysokińska Z., Witkowska J., *Integracja europejska. Rozwój rynków [European integration: Market development]*, 2nd Edition, PWN Scientific Publishers, Łódź–Warsaw, 2002