

SME AND FDI LINKAGE PROMOTION TC DOCUMENT

I. BASIC INFORMATION FOR TC

Country/Region:	Regional
TC Name:	SME and FDI Linkage Promotion
TC Number:	RG-T2347
Team Leader/Members:	Guilherme Piereck, Team Leader; (INT/TIU); Matias Bendersky (ORP/ORP); Joonseob Kwon (INT/TIU); Yasmin Esteves (INT/TIU);Rodolfo B. Graham LEG/SGO)
Indicate if: Operational Support, Client Support, or Research & Dissemination	Research & Dissemination
Beneficiary:	Brazil, Paraguay and Uruguay
Executing Agency and contact name:	The Inter-American Development Bank (IDB), through the Integration and Trade Sector (INT/INT)
Donors providing funding:	Knowledge Partnership Korea Fund for Technology and Innovation (KPKF)
IDB Funding Requested:	US\$550,000
Local counterpart funding, if any:	N/A
Disbursement period:	24 months
Required start date:	October 1, 2014
Types of consultants:	Firms and individuals
Prepared by Unit:	Trade and Investment Unit (INT/TIU)
Unit of Disbursement Responsibility:	Integration and Trade Sector (INT/INT)
TC Included in Country Strategy (y/n):	No
TC included in CPD (y/n):	No
GCI-9 Sector Priority:	Competitive Regional and Global Integration

II. OBJECTIVES AND JUSTIFICATION OF THE TC

- 2.1 The objective of this TC is to create technological and innovative basis for local economic development through enhancing Small and Medium-sized Enterprises (SME) and Foreign Direct Investment (FDI) linkage in Brazil, Paraguay and Uruguay. To achieve this goal, this operation will pursue the following specific objectives: (i) exchange and disseminate best practices in enhancing SME and FDI linkages; and (ii) identify and suggest an optimal solution in the local context, with special emphasis on technology industry
- 2.2 SME are the engines of most local economies. Studies have shown that for every dollar invested in a SME, 12 additional dollars are generated for the rest of the local economy by using local resources, producing intermediate goods and transferring

rural technology leading to job creation and wealth generation.¹ FDI attraction generates valuable economic benefits to the region, promoting technology transfer and productivity. In addition, there is a strong positive correlation between a country's FDI inflows and its export structure upgrading in developing countries.² In this context, Special Economic Zones (SEZ) can be a highly useful SME and FDI promotion mechanism to enhance industry competitiveness, create jobs, develop and diversify exports³, encouraging technological improvements. A number of recent trends suggest that there may be great scope for developing the FDI-SME linkage such as SME internationalization and their integration to the global economy.⁴

- 2.3 Brazil captured the highest share (31%) in Latin America and the Caribbean (LAC) inflows of FDI in 2011.⁵ The country's exports of goods and services have grown sharply in recent years with sales nearly three times higher in 2010 than in 2000.⁶ However, Brazil faces considerable competitiveness challenges both in investment and export performances. The vast majority of FDI has traditionally been concentrated in the country's South and Southeast states⁷ and the export performance depends mostly on favorable geographical and sector composition effects. Brazil revised the legal framework for SEZ in 2008, but the legislation of the Export Processing Zones (EPZ) needs to be updated again since among the almost 30 EPZ that were recently approved, none has come into operation in 2013.⁸
- 2.4 According to the IMF, Paraguay's economy will grow more than 8%⁹ in 2013. Bolstered by a consolidation of macroeconomic stability, the economy has the potential to grow at annual average rate of 4.5% in the medium term. The country's growth outlook will hinge largely on the performance of the export-oriented agricultural sector, which is subject to the vagaries of the weather as well as developments in the global economy affecting demand and prices for commodities. The government is in the process of negotiating one of the biggest investments in the country's history for the installation of an aluminum smelter and one big industrial park associated to it. The success of that investment totally depends on FDI inflows in its initial stage.¹⁰ The country has the opportunity to upgrade and implement strategies for its industry diversification and trade competitiveness by adopting best practices in FDI and SEZ.
- 2.5 A decade since its economic collapse, Uruguay has become a hotspot for investment, lured by its encouraging prospects for growth and political stability. Uruguay's Economic Freedom Score is nearly 70, making its economy the 36th freest at the

¹ Soros Economic Development Fund (2012).

² Torfinn Harding, Beata Smarzynska Javorcik (University of Oxford, FDI and Export Upgrading, 2011).

³ Thomas Farole, Gokhan Akinci (World Bank, Special Economic Zones, 2008, 2011).

⁴ David Smallbone (FDI and SME Development, 2007.)

⁵ Ernst & Young (Capturing the Momentum, 2012).

⁶ Octavio Canuto, Matheus Cavallari, José G. Reis (World Bank, Economic Premise, The Brazilian Competitiveness Cliff, 2012).

⁷ Kusi Hornberger, (World Bank, Brazil's new FDI frontier, 2012).

⁸ Ministry of Development, Industry and Foreign Trade (National Meeting of News Mayors, 2013).

⁹ Reuters (IMF sees Paraguay 2013 economic rebound of 8.5%, 2012).

¹⁰ The Economist Intelligence Unit (EIU Country Report, 2013).

world level.¹¹ The country's economy is expected to grow more than 4% in 2013¹². FDI inflows in Uruguay have increased significantly since 2008, making the country the 9th largest host country in the region.¹³ Despite this substantial growth, Uruguay is still facing economic headwinds and needs to diversify exports and FDI patterns that show excessive concentration on the primary sector. The country seeks SEZ strategies to develop and promote export and investment diversification, positioning it as a gateway into MERCOSUR and other markets in the region.

- 2.6 All things considered, SEZ can be an optimal means to promote the upward shift of the overall industry structure for Brazil, Paraguay and Uruguay. Korea may be a classic example of successful SEZ models, based on technology industry. Korean zones have shown remarkable effectiveness in terms of achieving both foreign exchange earnings and local value addition. For instance, net EPZ exports in Korea were over 60% in 2000 and the country's zone program was one of the most successful cases in developing significant backward supply linkage and sub-contracting relationships with domestic firms.¹⁴ Korea's unique experience in local value addition, industrial upgrading and technology transfer will provide critical lessons for those who seek local economic impacts through SEZ.
- 2.7 Under this background, this TC plans to contribute to the design and implementation of innovative SEZ models for promoting FDI, upgrading export platforms of SME, and enhancing linkages with local economies. To this end, this operation will provide best practices from the Korea's SEZ program that has successfully combined FDI attraction policies with SME export promotion activities.
- 2.8 The objective and activities of this operation correspond to the Banks' Sector Strategy to Support Competitive Global and Regional Integration since it will enhance trade and investment in the global/regional integration context through best practice sharing and pilot case study in areas of common interest.

III. DESCRIPTION OF ACTIVITIES/COMPONENTS AND BUDGET

- 3.1 As a knowledge-based institution, the Bank has been widely recognized as a key contributor to empowering the member countries in the region. This operation will provide opportunities to learn valuable lessons and know-how from Korea's development experience on SEZ, trying to suggest an alternative solution for local economies through SME-FDI linkages. For that purpose, this TC will take a two-level approach: (i) Best Practice Sharing; and (ii) Pilot Case Study, developing the following specific activities:
- 3.2 **Component 1. Best Practice Sharing (US\$150,000):** Best Practice Benchmarking is an effective strategic tool, evaluating others' operation processes and adapting them to incorporate best practices to improve performance, search for innovative ideas, and gain a competitive advantage. This component will provide opportunities to share the best practices of the Korea's Economic Zone Model that has shown remarkable

¹¹ The Heritage Foundation (Index of Economic Freedom, 2013).

¹² The Economist Intelligence Unit (EIU Country Report, 2013).

¹³ Uruguay XXI (FDI in Uruguay, 2012).

¹⁴ Gokhan Akinci, James Crittle (World Bank/FIAS, Special Economic Zones, 2008).

effectiveness in promoting SME exports and FDI attraction in a short period of time through the following two sub-components:

- 3.3 **Sub-component 1.1: Benchmark Report (US\$50,000):** A benchmark report on the Korea's SEZ Program will be provided for key stakeholders engaged in local SME-FDI promotion. This report will examine the Korean experience in SEZ, reviewing development patterns and economic impacts in Korea, focusing on SME-FDI promotion and its implications to LAC. Taking into consideration the operation's period, this consultancy will cover: (i) background and history; (ii) development patterns and trends; (iii) key characteristics; (iv) SME-FDI promotion policies; (v) economic performance and impacts; (vi) lessons learned and its implications for LAC. This activity will strengthen institutional capacity in planning, evaluating and upgrading local zone initiatives by sharing and applying key considerations and lessons presented in the report.
- 3.4 **Sub-component 1.2: Benchmarking Workshops (US\$100,000):** Based on the benchmark report, the Bank will develop a tailor-made workshop, respectively, in Brazil, Paraguay and Uruguay. The workshop aims to scale up use of knowledge-sharing practices, tools, and principles by the Korea's Free Economic Zone (KFEZ) or similar institutions to share their SME-FDI development experience with LAC. It will cover: (i) a cross-sector perspective of the present and projected growth of the Korea's SEZ model; (ii) lessons learned and its implications for each country; and (iii) opportunities to discuss and share an alternative view on local economic growth. This activity will help local stakeholders to understand, appreciate and customize the role and value of the FEZ in SME-FDI arenas.
- 3.5 **Component 2. Pilot Case Study and Knowledge Dissemination (US\$350,000):** Data and information cannot be knowledge until stakeholders fully make the best use of it by adapting the knowledge platforms to the local context. As a follow-up action of the benchmarking activities, this operation will seek to identify, analyze and suggest an optimal solution for SME and FDI linkage promotion. To this end, this component will finance: (i) a pilot case study to outline and narrow SME and FDI linkage development alternatives and; (ii) a final report briefing so that all the stakeholders can access and share the results.
- 3.6 **Sub-component 2.1: Pilot Case Study (US\$250,000):** Up to three (preferably, one for each country) Feasibility Studies (FS) for establishing SME-FDI promotion strategies, based on FEZ will be provided for local decision-makers and potential investors. This consultancy will cover overall information on: (i) project definition, (ii) location study, (iii) economic, environmental impact analysis and assessment, (iv) other determinants for the investment decisions; and (v) future action plans. Both location and industrial focus will be discussed and suggested by the Bank and local governments through the following three steps: (i) pre-identifying local demand on SME-FDI linkage, (ii) narrowing local SME-FDI development options; and (iii) selecting an optimal solution, considering each country's local demand and economic impact. For both site selection and industrial focus, priority consideration will be given to country strategy and private investors' feedback. This activity will assist the decision-makers in making the decision that will be in the best interest of SME-FDI promotion, providing specific development blueprints, enhancing the

probability of success and revealing deficiencies by addressing and mitigating all factors associated with it.

- 3.7 **Sub-component 2.2: Dissemination Event (US\$100,000):** After the FS has been completed, the Bank will organize dissemination events in cooperation with local SME-FDI promotion agencies, providing a summary of the final report to all those who are interested in local SME-FDI linkages. The event will include: (i) project summary, (ii) economic feasibility, (iii) key determinants to be considered, (iv) suggested next steps, (v) Q&A. This activity will serve both the Governments and the Bank in taking the next steps for mutual cooperation on the suggested theme.
- 3.8 In light of fostering multi-synergy effects, the Bank will combine the following pre-operating and follow-up activities with this component: (i) narrowing local SME-FDI development options before launching a FS, (ii) final report sharing with local stakeholders; (iii) analyzing and reflecting investor's feedback; and (iv) develop future development plans with local governments.
- 3.9 **Contingency, administration and Monitoring (US\$50,000):** This component will cover: (i) any uncertainties or unexpected elements associated with the normal execution of the operation; (ii) expense incurred in implanting, controlling and directing this TC; and (iii) operational costs for progress/performance monitoring activities. Given the Bank's unique role as a regional facilitator in this field (Integration through Trade, Investment and SME promotion), special missions by the Bank staff (INT/TIU and/or related teams) will be financed by this component in accordance with the bank's TC policy (GN-2470-2).

Indicative Results Matrix

Indicative Results Matrix								
Indicators		Baseline		Year 1 (2015)		Year 2 (2016)		Expected Completion Date
	Unit	Value	Year	Planned	Actual	Planned	Actual	
Component I: Best Practice Sharing								
A Benchmark Report on the SEZ Model in Korea	#	0	2014	1		-		07/31/2015
Final Report Sharing with local stakeholders (on/off line)	#	0	2014	3		-		09/01/2015
Benchmarking Workshops	#	0	2014	3		-		10/31/2015
Number of local participants (Workshops)	#	0	2014	90		-		10/31/2015
Workshop Performance Evaluation (Survey)	%	0	2014	75		-		10/31/2015
Component II: Pilot Case Study								
Pre-Identifying local demand on SME-FDI linkage	#	0	2014	2		-		05/31/2015
Narrowing local SME-FDI development options	#	0	2014	1		-		11/30/2015
A Feasibility Study on local SME-FDI development options	#	0	2014	-		1		03/31/2016
Final Report Sharing with local stakeholders (on/off line)	#	0	2014	-		1		05/31/2016
Knowledge Dissemination Event	#	0	2014	-		1		06/30/2016
Number of local participants in the event	#	0	2014	-		50		06/30/2016
Number of potential investors participating in the event	#	0	2014	-		30		06/30/2016
Event Performance Evaluation (Survey)	%	0	2014	-		50		06/30/2016
Event Wrap-up Report	#	0	2014	-		1		07/31/2016
Number of follow-up action with local governments ¹⁵	#	0	2014	-		3		08/15/2016

Indicative Budget (USD)

Activity/Component	Description	IDB/Fund Funding	Total Funding
Component 1	Best Practice Sharing	150,000	150,000
	1.1. Benchmark Report (1)	50,000	50,000
	1.2. Benchmarking Workshops (3)	100,000	100,000
Component 2	Pilot Case Study	350,000	350,000
	2.1. Feasibility Study (Up to 3)	250,000	250,000
	2.2. Dissemination Event (Up to 3)	100,000	100,000
Others (Contingency, administration and Monitoring)		50,000	50,000
TOTAL		550,000	550,000

¹⁵ It will be focused on future cooperation between the bank and local governments.

- 3.10 The total project estimate (US\$550,000) will be entirely supported by the Bank through the Knowledge Partnership Korea Fund for Technology and Innovation (KPKF). Budget details may be subject to change according to its work scope and local circumstances.
- 3.11 This TC will be directly supervised by the Bank through INT/TIU. The project team will be responsible for executing across the board.
- 3.12 This operation will be monitored by INT/TIU, guiding and encouraging productive outcomes including reports, studies, surveys and feedback in each stage, based on the result matrix and Terms of Reference (TOR). All reports, studies and events will be reviewed and approved every three months until the final completion. In case of necessity, special progress or performance monitoring missions will be financed by the Contingency and Monitoring budget.
- 3.13 Each component will be comprehensively evaluated, based on event performance surveys, investors, local stakeholders' and government officials' feedback and visible achievement associate with the operation. A final report will be submitted at the end of this operation, covering: (i) executive summary, (ii) background and context, (iii) description of the operation, (iv) key activities and major achievement, (v) feedback and evaluation, (vi) conclusion, and (vii) lessons learned among others. Evaluations costs are included in each component's budget.

IV. EXECUTING AGENCY AND EXECUTION STRUCTURE

- 4.1 This operation will be executed by the Trade and Investment Unit (INT/TIU) of the Integration and Trade Sector (INT/INT) of the Inter-American Development Bank (IDB) in accordance with the Bank's Technical Cooperation Policy (Document GN-2470-2). There are two main reasons that justify the execution of the project by the Bank. First, as a regional project that involves coordination with several public and private sector stakeholders in the region, the Bank is in a unique position to manage and coordinate the activities given its presence in the countries. Second, the Bank, through INT/TIU in particular, has gained invaluable know-how and experience in the execution of international trade and investment promotion activities.
- 4.2 The selection and contracting of consultant firms shall be carried out in accordance with the provisions of document GN-2350-9 ("Policies for selection and contracting of consultants financed by the Inter-American Development Bank"), for hiring individual consultants will apply the norms of IDB Human Resources and, for Logistical expenses will apply Corporate Policies (GN-2303-20).
- 4.3 Taking into consideration the Bank's unique role, experience and know-how over integration through trade, investment and SME promotion, its participation in the knowledge dissemination events is a critical success factor to ensure the operation's goals. In accordance with the Bank's TC policy (GN-2470-2, Paragraph 2.32), this TC will finance INT/TIU and other related team staff's missions providing technical assistance to this operation.

V. MAJOR ISSUES

- 5.1 The success of the project will depend on a significant level of engagement and participation of the relevant stakeholders. The operation will mitigate the risk by

engaging government officials and private sector representatives in the activities from the start of the TC and through an intensive promotion strategy.

VI. EXCEPTIONS TO BANK POLICY

6.1 This TC does not involve or require any exception to the Bank's policies.

VII. ENVIRONMENTAL AND SOCIAL STRATEGY

7.1 This operation does not present environmental and social risks. It was classified as Category "C" in the [Environmental and Screening Classification](#).

REQUIRED ANNEXES:

- Annex I: [Non-objection Letters](#)
- Annex II: [Terms of Reference](#)
- Annex III: [Procurement Plan](#)

SME AND FDI LINKAGE PROMOTION

RG-T2347

CERTIFICATION

I hereby certify that this operation was approved for financing under the Knowledge Partnership Korean Fund for Technology and Innovation (KPK) through a communication dated July 22, 2013 and signed by Mr. Jangro Lee, Director of the International Bureau, Ministry of Strategy and Finance of the Republic of Korea. Also, I certify that resources from said fund are available for up to US\$550,000 in order to finance the activities described and budgeted in this document. This certification reserves resources for the referenced project for a period of four (4) calendar months counted from the date of eligibility from the funding source. If the project is not approved by the IDB within that period, the reserve of resources will be cancelled, except in the case a new certification is granted. The commitment and disbursement of these resources shall be made only by the Bank in US dollars. The same currency shall be used to stipulate the remuneration and payments to consultants, except in the case of local consultants working in their own borrowing member country who shall have their remuneration defined and paid in the currency of such country. No resources of the Fund shall be made available to cover amounts greater than the amount certified herein above for the implementation of this operation. Amounts greater than the certified amount, may arise from commitments on contracts denominated in a currency other than the Fund currency, resulting in currency exchange rate differences, for which the Fund is not at risk.

ORIGINAL SIGNED

August 29, 2014

Sonia M. Rivera
Chief
Grants and Co-financing Management Unit
ORP/GCM

Date

APPROVAL

Approved:

ORIGINAL SIGNED

Sept. 17, 2014

Antoni Estevadeordal
Sector Manager
Integration and Trade Sector
INT/TIU

Date