

III. TRADE-RELATED ASPECTS OF INVESTMENT POLICIES

1. Up to 1989, foreign direct investment (FDI) into the Czech and Slovak Federal Republic was negligible, mainly comprising a few projects in construction and reconstruction of hotels.¹ An upsurge of FDI started with the introduction in 1991 of the radical market economy reform programme, including a liberal inward investment régime; thus, whereas in 1990 FDI amounted to US\$72 million, in 1992 it reached US\$1 billion. With continued economic advances, FDI into the Czech Republic is expected to be much higher in 1995 than in any of the previous years. As a result, the flow of FDI has become an important element in the balance of payments and plays a substantial rôle in privatization and related enterprise restructuring. The Government has not granted special incentives for FDI, having taken the view that a sound macroeconomic environment provides the best incentives for foreign (and domestic) investors.

(1) Legislative Framework for FDI

2. The basic rules on FDI into the Czech Republic are laid down in the Czech Commercial Code. Under Article 21 of the Code, foreigners "may conduct business activities under the same conditions and to the same extent as Czech persons, unless the law stipulates otherwise".

3. Under Czech law, foreign entrepreneurs have the right to: establish joint ventures with Czech investors²; establish an enterprise with 100 per cent ownership; and purchase Czech enterprises in the privatization process. In establishing their business undertakings, foreign nationals may choose from among the following ownership forms: joint-stock company; limited-liability company; ordinary or limited partnership; and a co-operative. Most foreign business ventures take the form of a joint-stock or limited-liability company.

4. Certain restrictions apply with respect to inward FDI, including: the granting of loans by domestic institutions for less than five years; the purchase of more than 15 per cent of the capital of existing banks and the stock exchange, which requires the prior approval of the Czech National Bank; and restraints on entry into auditing and engineering services (a minimum equity participation of 60 per cent by Czech nationals), and domestic air transportation (applications will be considered within the limits established by Czech laws and regulations or relevant bilateral agreements).

5. Czech laws and regulations provide guarantees for foreign investors.³ Under the Commercial Code, FDI or rights and interests in FDI, like domestic investment, may only be expropriated in the public interest and then only if no other possibility is available to satisfy public interest. Such a decision may be appealed before the courts. In the event of expropriation, compensation is to be provided without delay, and must correspond to the full value of the extent to which the property is affected by the measure; such compensation is freely transferable abroad in foreign currency. In addition, the Czech Republic has concluded bilateral agreements on investment protection and the avoidance of double taxation with its major investment partners, including France, Germany and the United States, which together have accounted for almost 70 per cent of FDI into the Republic in the last few years.

¹J. Charap and A. Zemplerova (1994).

²Foreign investments that establish lasting economic relations in a newly established or existing business activity are regarded as foreign direct investments according to the Foreign Exchange Law.

³The commitments of the Czech Republic under the Uruguay Round's General Agreement of Trade in Services (GATS) are noted in Chapter II(4)(i) and Chapter V(5).

(2) Incentives for FDI

6. The Czech Republic has consistently taken the position that a sound economic and political environment are the most important investment incentives. Therefore, the number of special incentives provided only for foreign investors is limited, with most incentives applied equally to domestic and foreign investors.

7. There are no tax holidays for investment in the Czech Republic, and according to the authorities no change is anticipated in the near future. Rather, the Government intends to pursue the policy of decreasing the tax burden generally. At present, tax consolidation is not permitted by Czech law; with individual entities each taxed separately.

8. For all investment by either foreigners or nationals in fixed assets, statutory tax depreciation periods range from four to 45 years.⁴ A 10 per cent investment allowance may be claimed on most new plant and machinery in the year of its purchase, subject to it being retained in use for a minimum of three years. Losses incurred after 1 January 1993 may be carried over against profits generated in the following seven years.

9. Profits made by joint ventures may be freely repatriated as dividends, subject to a 25 per cent withholding tax. In bilateral agreements on the avoidance of double taxation this rate has been reduced with most OECD countries to between 0 and 15 per cent. Examples of the rates of withholding tax on dividends provided for in bilateral agreements include: Austria, 10 per cent; Germany, 15 per cent (5 per cent for a minimum shareholding of 25 per cent); France, 10 per cent; and the United States, 15 per cent (5 per cent for a minimum shareholding of 10 per cent).

10. In general, relief from duty is not available for plant and machinery imports, even if imported as initial (in kind) capital for a local subsidiary of a foreign parent company. In accordance with the provisions of a Government Decree made 21 July 1993, special inward processing relief is available for joint ventures with foreign participation in respect of materials and components imported for processing and re-export. Thus, joint ventures in the Czech Republic with at least 30 per cent foreign ownership, equalling not less than the equivalent of US\$1.7 million, are allowed a year's exemption from customs duties on raw materials or semi-processed goods imported through the foreign partner for further manufacturing and re-export, the value of exports must be at least equal to that of the imported components. The Decree remains in force until the end of 1996.

11. Support from local authorities for inward FDI may be negotiated. Such support could consist of providing the necessary infrastructure, for example, energy, water supply, telecommunications, but also the recruitment of skilled labour, suitable accommodation for foreign specialists and schooling for their children. In some regions, investors are entitled to receive grants for every new job created (in the range of Kc 10,000 to 50,000 for each new job).

12. In November 1992 the Government established CzechInvest to assist foreign investors to set-up in the Czech Republic. Services of CzechInvest, which are mainly informational and serve to orientate the foreign investor, particularly with respect to the stipulations of the Commercial Code, are provided free of charge. CzechInvest has established a network of local representatives throughout the country.

⁴Examples of depreciation periods and the products covered are: four years for computers and automobiles, eight years for most machinery and equipment, and 45 years for buildings.

(3) Scope and Structure of FDI

13. The flow of inward FDI between 1990 and 1994 totalled about US\$3 billion (Table III.1), which amounted to one fourth of total FDI in the central and eastern European area and gave the Czech Republic the second rank in this area in terms of volume and per capita of FDI (Table III.2). Between 1990 and 1994, the most successful year in terms of volume of FDI was 1992 (US\$1 billion), followed by 1994 (US\$862 million).

Table III.1
FDI in Czech Republic
(US\$ million and per cent)

	1992		1993		1994		1990-94	
	US\$ m.	%	US\$ m.	%	US\$ m.	%	US\$ m.	%
Germany	158.2	15.8	82.0	14.4	417.6	48.4	1,113.0	36.2
United States	289.2	28.8	255.0	44.9	39.4	4.6	651.1	21.2
France	223.9	22.3	34.0	6.0	77.0	8.9	355.6	11.6
Austria	66.2	6.6	55.0	9.7	79.5	9.2	216.6	7.0
Belgium	87.9	8.8	32.0	5.6	n.a.	n.a.	188.6	6.1
Switzerland	80.0	8.0	13.6	2.4	39.3	4.6	136.7	4.4
Italy	66.2	6.6	12.0	2.1	n.a.	n.a.	92.5	3.0
Netherlands	12.9	1.3	30.0	5.3	n.a.	n.a.	n.a.	n.a.
Others	19.0	1.9	54.4	9.6	209.5	24.3	323.3	10.5
Total	1,003.5	100.0	568.0	100.0	862.4	100.0	3,077.4	100.0

n.a. Individual statistic not available; included under "Others".

Source: Czech Agency for Foreign Investment.

Table III.2
Foreign direct investment in selected economies in transition, 1990-94
(Cumulative total since 1988, US\$ million)

	Cumulative total					FDI per capita
	1990	1991	1992	1993	June 1994	
Albania	0	0	10	58	82	18
Bulgaria	4	60	101	157	182	17
Croatia	0	0	16	88	127	19
Czech Republic	436	947	1,951	2,519	2,820	242
Hungary	512	1,971	3,442	5,781	6,316	558
Poland	93	210	494	1,074	1,365	28
Romania	0	40	120	207	323	9
Slovakia	28	110	210	354	390	83
Slovenia	n.a.	41	152	263	292	130
FYR of Macedonia	21	59	74	89	96	45
Eastern Europe	1,094	3,438	6,571	10,590	11,993	99

Note: Figures in bold are estimates: zero means no, or a negative amount of investment occurred. Per capita figures are in US dollars.

Source: Economic Commission for Europe.

14. Latest reports indicate that 1995 was a successful year for FDI into the Czech Republic; through end-June, foreign capital increased by US\$0.4 billion.⁵ Portfolio investment in the first half of 1995 increased by US\$0.6 billion.

15. Between 1990 and 1994, Germany was the single largest source of inward FDI, with 36 per cent of the total, followed by the United States (21 per cent), France (12 per cent) and Austria (7 per cent) (Chart III.1).

16. The sectoral distribution of inward FDI indicates that consumer goods and tobacco, automotive industry, construction banks and insurance and the food industry were the industries of choice. The two largest investments were made by Volkswagen in the Skoda Mladà Boleslav car factory and Philip Morris in the Czech tobacco industry.

17. In 1992 foreign investors were involved in the privatization process of more than 200 enterprises, primarily industrial. Privatization projects with foreign participation can be highly controversial, since they generally concern the best enterprises in the economy. At the end of 1992, privatization projects with foreign participation represented only 1.2 per cent of all projects, but foreign participation was the source of 52 per cent of all proceeds from large scale privatization.⁶ By September 1994, the share of projects with foreign participation increased to 3.2 per cent. The Ministry of Privatization received 315 projects recommending the sale of units to foreign investors. More than 150 of them were rejected because the proposed investors did not approve the conditions of the transaction. By source, the principal investors in the privatization process are Germany (30 per cent), and the United States (25 per cent), followed by France, Austria, Belgium, Switzerland and Italy.

(4) Czech Direct Investments in Foreign Countries

18. Direct investment made by Czech entities in foreign countries was equivalent to US\$56 million in the first half of 1994, more than twice the amount for the first half of 1993. Most of the investment was in Austria and Slovakia, followed by Ukraine, Turkey and Germany, and was mainly to support Czech exports and imports. According to the authorities, outgoing direct investment is free of restrictions.

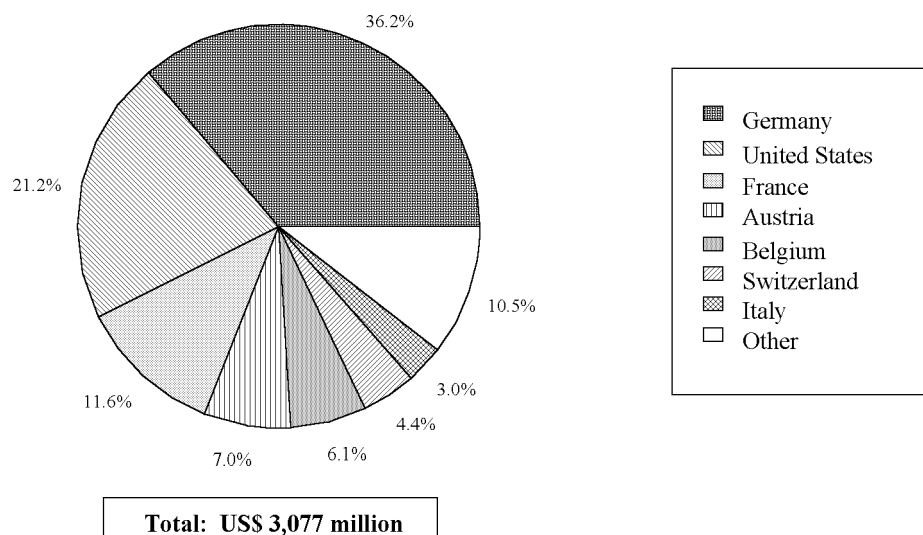
⁵Data provided by the Czech National Bank.

⁶J. Charap and A. Zemplerova (1994), pp. 32-33.

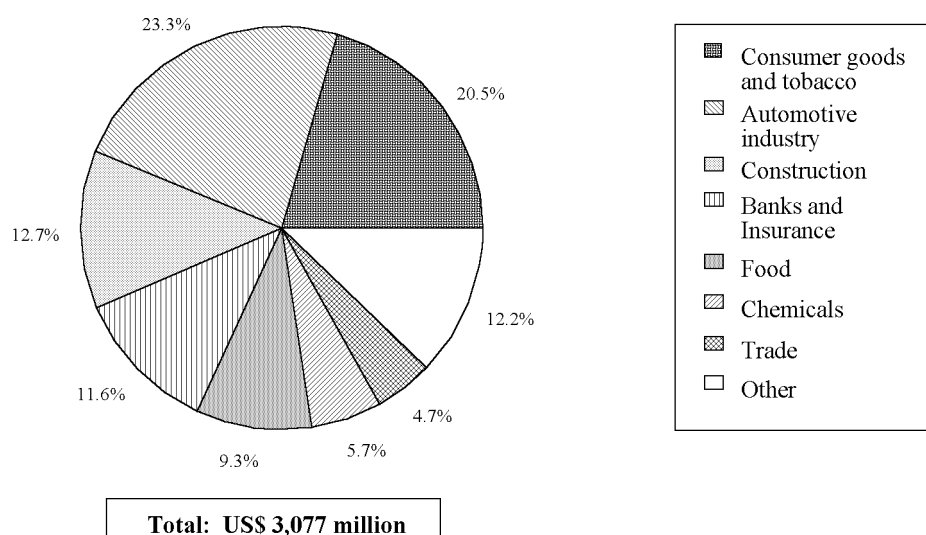
Chart III.1 FDI by source and sector, 1990-94

US\$ million and per cent

Source



Sector



Source: CzechInvest.