TC ABSTRACT

I. Basic project data

▪ Country/Region:	Regional
▪ TC Name:	Local Economic Development through enhancing SME and FDI linkage
▪ TC Number:	RG-T2347
▪ Team Leader/Members:	Pablo Marcelo García (Team Leader, INT/TIU); Matias Bendersky (ORP/ORP); Guilherme Piereck (INT/TIU); Joonseob Kwon (INT/TIU); and Yasmin Esteves (INT/TIU).
▪ Indicate if: Operational Support, Client Support, or Research & Dissemination.	Research and Dissemination
▪ If Operational Support TC, give number and name of Operation Supported by the TC:	N/A
▪ Reference to Request: (IDB docs #)	N/A
▪ Date of TC Abstract:	June 30, 2013
▪ Beneficiary:	Regional
▪ Executing Agency and contact name:	Trade and Investment Unit (INT/TIU)
▪ IDB Funding Requested:	USD$550,000
▪ Local counterpart funding, if any:	N/A
▪ Disbursement period:	24 months
▪ Required start date:	August 1, 2013
▪ Types of consultants (firm or individual consultants):	Firms and individuals
▪ Prepared by Unit:	Trade and Investment Unit (INT/TIU)
▪ Unit of Disbursement Responsibility:	Trade and Investment Unit (INT/TIU)
▪ Included in Country Strategy (y/n); ▪ TC included in CPD (y/n):	No
▪ GCI-9 Sector Priority:	Competitive Regional and Global Integration

II. Objective and Justification

2.1. The objective of this operation is to contribute to the internationalization of Small and Medium-sized Enterprises (SME) and to exchange and disseminate best practices in incentive mechanisms to attract Foreign Direct Investment (FDI) in Brazil, Paraguay and Uruguay.

2.2. SME and FDI are the key components of a nation's economic growth on a sustainable basis. SME are the engines of most local economies. Studies have shown that for every dollar invested in an 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

[1] Soros Economic Development Fund (2012)

attraction generates valuable economic benefits to the region. Accordingly, every dollar spent on investment promotion generates FDI inflows by US$189 and US$78 spent on the same activities creates an additional job by a foreign affiliate[2]. There is a strong positive correlation between a country's FDI inflows and its export structure upgrading in developing countries[3]. Moreover, Special Economic Zones (SEZ) and Industrial Parks (IP) are highly useful FDI promotion mechanisms to enhance industry competitiveness, create jobs, develop and diversify exports[4]. A number of recent trends suggest that there may be greater scope for developing the FDI-SME linkage such as SME' internationalization and their integration to the global economy[5].

2.3. Brazil captured the highest share (31%) in Latin America and the Caribbean inflows of FDI in 2011[6]. 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[7]. 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 states[8] 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[9]. The country seeks to upgrade FDI promotion mechanisms in order to improve regional economic unbalances and industrial competitiveness that may produce ripple effects on neighboring countries.

2.4. According to the IMF, Paraguay's economy will rebound in 2013 and grow more than 8%[10]. 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. Paraguay, however, is in great need of FDI for its economic momentum. 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[11]. The country needs 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,

[2] World Bank (GIPB, 2012), University of Oxford (Roll out the Red Carpet and They Will Come, 2011).
[3] Torfinn Harding, Beata Smarzynska Javorcik (University of Oxford, FDI and Export Upgrading, 2011).
[4] Thomas Farole, Gokhan Akinci (World Bank, Special Economic Zones, 2008, 2011).
[5] David Smallbone (FDI and SME Development, 2007.)
[6] Ernst & Young (Capturing the Momentum, 2012).
[7] Octavio Canuto, Matheus Cavallari, José G. Reis (World Bank, Economic Premise, The Brazilian Competitiveness Cliff, 2012).
[8] Kusi Hornberger, (World Bank, Brazil's new FDI frontier, 2012).
[9] Ministry of Development, Industry and Foreign Trade (National Meeting of News Mayors, 2013).
[10] Reuters (IMF sees Paraguay 2013 economic rebound of 8.5%, 2012).
[11] The Economist Intelligence Unit (EIU Country Report, 2013).

making its economy the 36th freest at the world level[12]. The country's economy is expected to grow more than 4% in 2013[13]. FDI inflows in Uruguay have increased significantly since 2008, making the country the 9th largest host country in the region[14]. Despite this substantial growth, Uruguay is still facing economic headwinds and need 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 the zones as a gateway into MERCOSUR and other markets in the region.

2.6. Under this background, this TC plans to implement and upgrade SEZ models for promoting FDI, upgrading export platforms of SME, and enhancing linkage with local economies. In this context, this operation will provide best practices from Republic of Korea that successfully combined FDI attraction policies with SME export promotion activities, using SEZs as an essential tool.

2.7. The objective and activities of this operation correspond to the Banks' Sector Strategy to Support Competitive Global and Regional Integration (GN-2649-2, GN-2470-2) as it will enhance trade and investment in the global/regional integration context through: knowledge sharing, capacity enhancement and pilot case study in areas of common interest.

III. Description of activities and outputs

3.1. As a knowledge-based institution, the bank has been widely recognized as a key contributor to empowering the country partners in the region. This operation will provide our partners opportunities to learn valuable lessons and know-how from Korea's development experience. It will also try to identify and implement a pilot case study by adapting knowledge platforms to the local context. To this end, this TC will develop the following two components:

3.2. Component I. Best Practice Sharing: Seeking to improve Brazil, Paraguay and Uruguay's level of FDI promotion, this component will provide opportunities to share the best practices of the Korea's Economic Zone Model engaging SME and FDI promotion through the following sub-components: (a) a benchmark report on designing, developing and operating Korea's best practices in local economic development through SME and FDI promotion linkage and its implications to LAC; (b) benchmarking workshops on designing, developing and operating from EPZ to SEZ, based on the benchmark report. The workshops will be held in Brazil (Fortaleza o Manaus), Paraguay (Asunción) and Uruguay (Montevideo), respectively during the operation period.

3.3. Component II. Pilot Case Study: This component will seek to identify and implement three pilot case studies in a target area, particularly in the manufacturing sector, by adapting knowledge platforms to the local context. To this end, three pilot case studies (one for each country) will be financed by this component. Each pilot case will include: (a) developing a strategic plan for upgrading manufacturing

[12] The Heritage Foundation (Index of Economic Freedom, 2013).
[13] The Economist Intelligence Unit (EIU Country Report, 2013).
[14] Uruguay XXI (FDI in Uruguay, 2012).

industry through FDI or an initial stage Pre-Feasibility study including overall information on site identification, evaluation, selection, economic, environmental impact analysis, legal, regulatory incentives, restrictions, financial plans cash flow analysis and assessment as key determinants for the investment decisions; (b) providing a final report briefing of the pilot case study so that stakeholders can access and share the results (if necessary).

IV. Indicative Budget (USD)

Activity/Component	Description	IDB/Fund Funding	Counterpart Funding	Total Funding
Component 1	**Best Practice Sharing**	**150,000**	-	**150,000**
	Benchmark report (Report)	50,000		50,000
	Benchmarking Workshops (Event) - Event 1 (Brazil) - Event 2 (Paraguay) - Event 3 (Uruguay)	100,000 - 40,000 - 30,000 - 30,000	-	100,000 - 40,000 - 30,000 - 30,000
Component 2	**Pilot Case Study**	**350,000**	-	**350,000**
	Strategic Plan or Pre-Feasibility Study (Report) - Report 1 (Brazil) - Report 2 (Paraguay) - Report 3 (Uruguay)	250,000 - 130,000 - 60,000 - 60,000	-	250,000 - 130,000 - 60,000 - 60,000
	Final Report Briefing (Event) - Event 1 (Brazil) - Event 2 (Paraguay) - Event 3 (Uruguay)	100,000 - 40,000 - 30,000 - 30,000	-	100,000 - 40,000 - 30,000 - 30,000
Progress Monitoring		**20,000**		**20,000**
Contingency		**30,000**	-	**30,000**
TOTAL		**550,000**		**550,000**

V. Executing agency and execution structure

5.1 This operation will be executed by the Trade and Investment Unit (INT/TIU) 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 the Trade and Investment Unit of the integration and Trade Sector in particular, has gained invaluable know-how and experience in the execution of international trade and investment promotion activities and forum.

5.2 In addition, the INT/TIU has gained invaluable know-how in the execution of international promotion activities with Korea such as LAC-Korea (2011) and LAC-Korea Investment Promotion Training

Workshop (2012) among others. The unit's solid partnership will provide this operation with more opportunities to accelerate the deployment of knowledge, experience and industrial cooperation.

5.3 The contracting of project consultants will be carried out by the Bank in accordance with document GN-2350-9 (Policies for the Selection and Procurement of Consulting Services Financed by the IDB), while the goods and related services will be carried out by the Bank in accordance with document GN-2349-9 (Policies for the Procurement of Goods and Works Finances by the IDB).

VI. Project risks and issues

6.1. 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.

VII. Environmental and Social Classification

7.1. This operation does not present environmental and social risks. It was classified as Category "C" in the Environmental and Screening Classification. (See IDBDOCS# 37777193)