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The good, the bad and the ugly
Assessing the costs, benefits and options for policy reform

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*This draft is intended to be a **working draft**. We welcome relevant feedback, comments and corrections to incorporate when preparing the final version. Proceedings from the conference will also be incorporated. Please send any suggestions or additional resources to vcc@law.columbia.edu by November 22, 2013; while we will not be able to respond to each email, we will work to incorporate as much input as possible.*

We will also prepare a list of references. If you would like to add your research to this list, please send a short abstract of a completed paper and indicate for which section of the report it is relevant.

Please excuse the typos and any errors in this working draft.

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Introduction

Governments – whether acting at the supra-national, national, or sub-national level – have long used incentives to shape the conduct of economic actors. Much of such government action is subject to criticism on the grounds that, while it might serve the needs of some, on the whole it distorts the normal functioning of markets and results in the inefficient allocation of resources. For instance, the unnecessary costs to governments' budgets from the excessive use of fiscal (tax) and financial incentives can lead to a narrowing of the tax base and the loss of public revenue necessary to provide essential public goods and services.

The government intervention, however, can be crucial for advancing public objectives and correcting the market failures caused by information asymmetries, externalities, economies of scale and other circumstances. By encouraging such activities as production of public goods, internalization and reduction of negative externalities, investment in R&D, and generation of economic activity and employment in undeveloped or marginalized areas, incentives can produce positive outcomes that the market alone may not achieve.

In the context of investment incentives in particular, there has been an apparent rise in governments' efforts to use incentives as a tool to attract and retain capital that is increasingly mobile. In efforts to create employment, increase competitiveness, generate exports, and encourage and build up their tax bases, governments are using incentives to convince investors to forgo *other* incentive opportunities offered by competing jurisdictions; and to bring and keep their businesses in that jurisdiction. Once the businesses are there, incentives are also being used to encourage the investments to deepen linkages with and spillovers into the host jurisdiction; in this context governments may offer incentives for businesses to hire local employees, procure their goods and services from local providers, and invest in education and training.

In addition to those efforts aimed at bringing in, keeping, and benefitting from investment, more governments are giving incentives to encourage domestic firms to grow abroad, providing this support based on the premise that outward investment can produce positive externalities in the home country.

The key question is whether and in what circumstances the costs of incentives used to encourage, influence, and retain investments outweigh their benefits. It is a question that is exceedingly difficult to answer given that the costs and benefits can be dispersed (both within the jurisdiction offering the incentive and outside of it), and may vary over time. Nevertheless, it is a question that some domestic jurisdictions, as well as international institutions and organizations such as the EU and the World Trade Organization (WTO) have dealt with to some extent, establishing rules regarding when, why, and how governments may take action to support and shape private economic activity. Those efforts, however, have so far been limited in terms of geographic scope (in the case of national and sub-national efforts, or supra-national efforts as is done in the EU) and substantive coverage (e.g., as in the context of the WTO's Agreement on Subsidies and Countervailing Measures, being limited to subsidies relating to trade in goods).

In order to lay the foundation for addressing those questions, this paper provides a description of the investment incentives used by governments across different regions of the world, drawing on several sets of data. Given that developed economies are more transparent in disclosing their use of incentives, their data are more represented in our paper.¹ Overall, however, information regarding use of incentives in developed and developing countries remains opaque and likely under-represents their use as requirements for such data to be collected and publicly disclosed are the exception, rather than rule.²

The main findings of this paper are that investment incentives are used pervasively across both the developed and developing world, with some notable moderation occurring in the European Union (EU) owing to the impact of State aid laws.³ Whether measured as a percentage of government revenues, the percentage of the value of the investment being incentivized, or the cost per job created, these incentives are often costly. In Rwanda and Sierra Leone, for instance, the governments devote more than one-third of tax revenues to investment incentives.⁴ In Brazil, investments have been given incentives worth 75 percent of the cost of the investment;⁵ while in the Czech Republic, the government's incentive packages granted between 2010 and 2013 amounted, on average, to more than one-third of the capital expenditures for the relevant projects. In terms of the cost of incentives per job created by an investment project, governments in the US,⁶ Brazil⁷ and India⁸ have all paid over \$200,000 in incentives per position and in the EU, investments by General Motors in Hungary and Dow Chemicals in Germany cost US\$300,000 and US\$800,000 respectively per job created.⁹

Tax incentives and grants are the most prevalent types of incentive instruments used for developed and developing countries, though technical and business support measures are common and important.¹⁰ Among tax incentives, tax holidays, which used to be the most prevalent form of tax

¹ As is referenced in the text, for our research on the use of incentives and their relevance for investors' decisions, we draw on various invaluable resources, including the data collected by the Investment Consulting Associates (ICA) database which, in particular, tracks incentive deals; surveys done by the United Nations Industrial Development Organization (UNIDO) and the United Nations Conference on Trade and Development (UNCTAD); data assembled by the Asian Development Bank for Asia; information disclosed by EU member states and reported by the European Commission; and research done by officials the World Bank and Professor Kenneth Thomas.

² Kenneth P. Thomas, *Investment Incentives and the Global Competition for Capital* (New York: Palgrave MacMillan 2011), ch. 3., p.4.

³ Although experts assert that EU rules on State aid are often circumvented.

⁴ James, S. 2013, *Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications*. World Bank Investment Climate Advisory Services. September 2013.

⁵ Thomas, ch. 7, p. 10.

⁶ See *infra*, section 2; Thomas, ch. 4, p. 4.

⁷ Thomas, ch. 7, p. 30.

⁸ Thomas, ch. 7, p. 30.

⁹ Oxelheim, L. & Ghauri, P. (eds.) (2004), *European Union and the Race for Foreign Direct Investment in Europe*, Elsevier.

¹⁰ Some experts would assert that information and technical services are even more prevalent than financial and even fiscal measures, but that this is hard to evidence. Their assertion is based on the fact that when there is an investment promotion agency, it is associated with the provision of information and certain services in all cases as a general matter but not necessarily with fiscal and financial incentives.

incentives across regions are today most prevalent in South Asia, Eastern Europe and Central Asia and the East Asia Pacific countries while they are least prevalent in the OECD countries, owing the fact that there is recent awareness in developed countries regarding their ineffectiveness in aligning the incentives of increased investment with the tax benefits.

Governments also use other tools, such as regulatory incentives, through which they provide investments special treatment under the law. Overall, the mix of measures varies widely between and within countries, with each type of incentive having its own set of policy implications and its own degree of attractiveness for its intended beneficiaries.

The targeting of incentives, in terms of who can access them and over which time periods, can be very specific and aimed at achieving a particular policy goal, such as developing supplies of renewable energy. However more often than not, incentives are available quite widely, across a broad segment of the economy in the extractive industries, manufacturing, and service sectors (though the details of individual deals are frequently negotiated on a case-by-case basis).

Significantly, despite their prevalence and costs, the effectiveness of incentives is open to question: While outcomes vary depending on the type of investment project and characteristics of the host location at issue, a common report by investors is that incentives are neither crucial to their decision regarding whether to make a particular investment, nor where to make it. The incentives thus frequently are merely “icing on the cake” – an unnecessary or inadequately tailored benefit conferred on investors by governments eager to attract and keep their business.

As this report describes, some governments are taking steps to restrict the granting of superfluous incentives, and to ensure that, when granted, the advantages of incentives outweigh their costs. Similarly, a few countries have endeavored to address “poaching” within their borders and with other nations, aiming to combat the practice of using incentives to simply pull an investment from one location to another. Although the EU has relatively robust controls on its member states use of incentives, much falls out of the scope of its regulations;¹¹ and outside of the EU, regulation of incentives remains either absent or largely incomplete. Some relevant national and sub-national initiatives have been launched by countries, states and provisions in different parts of the world, but have either failed or are weak. International instruments such as bilateral and multilateral investment treaties and the World Trade Organization’s Agreement on Subsidies and Countervailing Measures contain relevant provisions, but also fail to regulate the sphere.

Structurally, the paper proceeds as follows: Section One gives the necessary introduction to the concept of investment incentives, looking at the main types of incentives used and particular issues that arise in connection with incentives for foreign direct investment (FDI). Section Two looks at

¹¹ One might claim that even within the EU, the framework is incomplete: State aid regulations do not include supports provided by EU institutions, and are often undermined by the lack of fiscal harmonization, hidden State aids, the exceptions due to cohesion arguments, and the “other” incentives (e.g. infrastructure development favoring certain specific investments). See Section 4 for more information.

the actual data reported by diverse sources, the goal being to assess the pervasiveness of investment incentives in a variety of jurisdictions. Section Three reports practical efforts geared towards the governance and monitoring of incentives at the national level, focusing on efforts to analyze the costs and benefits of those tools and ensure that they further relevant policy aims. Section Four then focuses on the global governance frameworks that can limit the “race to the bottom.” The report concludes by identifying key policy issues and strategies that can be pursued in order to help discipline the use of incentives and ensure that, when used, they are adequately tailored to be consistent with and advance long term sustainable development.

DRAFT

Section 1: Definitions and types of incentives

Incentives are non-market benefits used to influence the behavior of an economic actor.¹² They can range widely in form and may be, for example, a requirement on purchasers to buy goods or services at above-market prices; full or partial exemptions or deferrals of tax charges; and the freedom from having to comply with certain laws and regulations. Because this paper discusses incentives in a broad context, we adopt a flexible approach to the term, but note where different definitions may be used in connection with data collection, reporting, and regulation.

FDI and incentives

Our definition does not differentiate between incentives used to favor foreign or domestic capital, and therefore is not limited to FDI incentives per se. This is because the programs offering investment incentives often do not distinguish between foreign or domestic investors, and the costs, benefits, and rationales for such incentives do not vary based on whether the recipients are foreign or domestic, but rather based on the characteristics and activities of the particular beneficiaries (which may correlate with nationality but are not inherent to or a necessary product of it). Nevertheless, there are some attributes of FDI related to its role in the global economy that are relevant to analysis of the use of investment incentives.

For one, FDI may often be seen as particularly valuable because it can provide access to capital and technology unavailable in the domestic market. It is not the “foreignness” of the investment necessarily that is attractive, but the fact that the investment possesses unique strengths that can compensate for weaknesses or fill gaps in the host economy. This may especially be the case in developing countries, where domestic entities can lack the financial resources, know-how, and supportive infrastructure necessary to meet the needs of the domestic population and be competitive in an increasingly globalized world. Yet, as evidenced by the recent financial crisis where developed countries ratcheted up their efforts to attract capital from China, FDI patterns are increasingly diverse and multi-directional.

FDI, moreover, is a growing force in the global economy and that trend appears likely to continue, with important policy implications for governments. Stock of outward FDI that amounted to USD 2 trillion in 1990 had grown to USD 21 trillion by the end of 2011. The multinational enterprises behind these figures are now key drivers of international trade. Evidencing this fact, roughly eighty percent of worldwide exports of goods and services involve the international production networks of these firms, and approximately thirty percent of total trade is between entities belonging to the same corporation or group.¹³

These trends have been enabled by legal shifts at the domestic and international level: in addition to unilaterally liberalizing their economies, states over the past two decades have been more intensely involved in concluding trade and investment treaties in which they commit to allow foreign individuals and entities to invest in their territories, and to permit the free flow of capital, goods, and services across borders. In contrast to the 1994 General Agreement on Trade in Services, in which WTO member states specifically selected which sectors to open up to foreign investors, a growing

¹² Dunning J, *Multinational Enterprises and the Global Economy* (1993).

¹³ UNCTAD, *World Investment Report 2013: Global Value Chains: Investment and trade for development*, p. 135.

body of bilateral and multilateral agreements obligate states to allow foreign investment in all sectors except those specifically reserved. Investment treaties also contain provisions on “free transfers” ensuring that, once in a particular host country, investors have significant freedom to move capital in and out of that territory when launching, operating, and disposing of their businesses.

Such trade and investment agreements consequently facilitate multinational enterprises’ efforts not only to spread their activities, value chains, and cash flows across borders, but also to move those activities as conditions in host countries and markets change. As firms’ options and mobility increase, it becomes more difficult for states to get those investments (and the jobs, revenues, and positive spillovers they can generate) to “stick”. Additionally, whereas competition to attract and keep firms may formerly have been largely between different jurisdictions in one country, the mobility of firms means that the field of competitors has been growing and now often crosses national borders.

Relatedly, the increasing complexity of multinational enterprises’ corporate structures – the relationships between parent firms and their subsidiaries and affiliates, branches, and holding companies – means that incentives provided in one location can often be effectively utilized by a firm operating in a different location. Transfer pricing, which can be exceedingly difficult to identify and combat, is one such mechanism that allows firms with a presence in a tax “light” location, or where substantial tax incentives are offered, to choose to record revenues and/or profits in that location rather than in a more highly taxed location. In addition to affecting the attractiveness of a particular incentive for the firm, this can also affect how the costs of the incentive are felt not only in the jurisdiction granting the advantage, but also in other locations where the firm’s affiliates are located (see Box 7).

In addition to those issues of transfer pricing, which can influence the calculation and distribution of benefits associated with a given incentive, the distribution of international production through global value chains can also impact whether and to what extent FDI will produce the benefits anticipated by the host country. While patterns can differ based on the firm, its place in the corporate family, and relevant industry and sector, FDI by a multinational enterprise may utilize fewer domestic inputs than a domestic counterpart, and may also repatriate, rather than reinvest, a greater share of its revenues. For instance, while efficiency-seeking FDI in services and manufacturing might be motivated to invest in maintaining and upgrading facilities and operations in the host country, revenues from FDI in extractive industries may be more likely to be repatriated after upfront capital expenditures have been made. These features and patterns will shape the nature and degree of firms’ impacts on host countries, and the desirability of incentivizing those firms’ investment.

FDI can provide important benefits for host (and home (See Box 1)) countries, but also poses challenges that can be hard to predict, identify, and manage. These issues, in turn, make it difficult for governments to identify whether, to what extent, in what circumstances, and how to incentivize such investment. Moreover, while FDI increases the complexity of calculations for the incentive granter, it provides advantages to firms shopping for incentives when deciding where to locate.

Those firms can exploit the fact that a given enterprise frequently has a range of potential locations available to it, while information asymmetries regarding firms' locational decisions leads would-be hosts to compete for their business. The case of Ireland illustrates this issue (see Box 9).

FDI, firm motives, and incentives

Firms engaging abroad through FDI do so for various motives, which can be grouped into four main categories briefly summarized as:¹⁴

- **Market-seeking FDI:** FDI through which a firm searches for new consumers of its goods or services.
- **Resource-seeking FDI:** FDI motivated by the availability of, and access to, natural resources, raw materials or low-skilled labor in a host country.
- **Strategic-asset-seeking FDI:** FDI driven by a firm's desire to acquire tangible or intangible assets (e.g., advanced technology owned by the target company) in order to strengthen its own position and/or weaken the position of its competitors.
- **Efficiency-seeking FDI:** FDI that occurs when firms seek to decrease their costs of production by transferring production to locations with low labor costs or rationalizing their operations.

Factors in the host country then influencing *where* firms undertake this FDI include **(a) the general policy framework for FDI, (b) economic factors and (c) business facilitation.** Table 1 illustrates how these determinants – firm motives and host country characteristics – interact to influence where FDI occurs.¹⁵

Table 1: Locational determinants of foreign direct investment

Policy framework for FDI
<ul style="list-style-type: none"> • Economic, political and social stability • Rules regarding entry and operations • Standards of treatment of foreign operations • Policies on functioning and structure of markets (esp. competition, M&A; and corporate governance) • Privatization policy • Trade policy (tariffs and NTBs) and coherence of FDI and trade policies • Tax policy • Good governance • Protection of property rights (including intellectual property) • Industrial and regional policies; development of competitive clusters • Stable exchange rates

¹⁴ Dunning, J., *Multinational Enterprises and the Global Economy* (1993).

¹⁵ UNCTAD, *World Investment Report 1998: Trends and determinants*, UNCTAD, *World Investment Report 2000: Cross-border Mergers and Acquisitions and Development*; Krueger, R. and Strauss, I., "Regional integration as a determinant of FDI?", *African Development Bank Working Paper Series*, forthcoming (2014).

Economic determinants by MNE motive	
Market-seeking motive	<ul style="list-style-type: none"> • Market size and per capita income • Market growth • Access to regional and global markets • Country specific consumer preferences • Structure of markets
Natural resource-seeking motive*	<ul style="list-style-type: none"> • Access to raw materials • Access to natural resources • Access to low-skilled labor
Strategic asset-seeking motive*	<ul style="list-style-type: none"> • Access to skilled labor • Access to new competitive advantages, e.g. coming from firm-specific technological and other created assets (e.g. brand names) • Availability of and access to strategic infrastructure (e.g. ports, roads, power, telecommunication, oil pipelines)
Efficiency-seeking motive	<ul style="list-style-type: none"> • Cost of resources and assets listed under resource- or asset-seeking, • Other input costs, especially transportation and communication costs • Costs of other intermediate products • Membership of a regional integration agreement conducive to the establishment of regional corporate networks • Low-cost unskilled or skilled labor • Different comparative advantages of countries • Better deployment of global resources
Business facilitation	
<ul style="list-style-type: none"> • Investment promotion (image-building, actions to reduce information asymmetries, etc.) • Investment incentives (fiscal, financial, regulatory, and other) • Technical services, including: <ul style="list-style-type: none"> ○ Reduction of hassle costs (related to corruption, administrative efficiency, etc.) ○ Provision of social amenities (bilingual schools, quality of life, etc.) ○ Provision of after-investment services ○ Availability of “one-stop shop” services to centralize procedures and information 	

Sources: Based on UNCTAD (1998; 2010) in Krueger and Strauss (2014).

Note: *UNCTAD (1998) has the two categories of natural resource-seeking and strategic asset-seeking motives grouped together as “Resource/asset seeking” motives.

Incentives can have varying impacts on these three locational determinants that, in turn, can potentially influence the decisions of market-seeking, resource-seeking, strategic-asset seeking, and efficiency-seeking FDI. A number of studies, however, indicate that the role of incentives in influencing investment decisions is often minimal (Table 2).

Table 2: Incentives and Locational Decisions - Survey

Author	Focus of survey	Conclusion	Did incentives influence Investment level? (share saying yes)
Investment Climate Advisory (FIAS)— investor motivation surveys	Burundi (2011)	Redundancy ratio for incentives (Would have invested even if incentives were not provided)	77%
	Guinea (2012)		30%
	Jordan (2009)		92%
	Kenya (2012)		6%
	Nicaragua (2009)		70%
	Rwanda (2011)		28%
	Serbia (2009)		61%
	Tanzania (2011)		15% (51% for non-exporting firms outside free zones)
	Tunisia (2012)		17%
	Uganda (2011)		98%
FIAS ¹⁶	Vietnam (2004)	85%	-
FIAS ¹⁷	Thailand (1999)	81%	-
Nathan Associates ¹⁸	Mozambique (2009)	78%	13%
Guisinger and Associates (1985)	Investment incentives and performance requirements for export-oriented firms	33%	

¹⁶ Phu and others, 2004, “An Empirical Study of Corporate Income Tax Investment Incentives for Domestic Companies in Vietnam,” USAID.

¹⁷ FIAS, 1999 “Kingdom of Thailand - A Review of Investment Incentives”. Foreign Investment Advisory Services

¹⁸ Bruce Bolnick, 2009. “Investing in Mozambique – The role of Fiscal Incentives”. Report by Nathan Associates for USAID.

Reuber (1973) ¹⁹	FDI and market orientation		52% for export-oriented firms
Mckinsey— Multinational corporation investment in developing economies (2003)	Business process outsourcing (BPO) and automobile sectors in India (2003)	Incentives not among top 3 factors driving location decisions	
Fortune/Deloitte and Touche (1997)	Business location study	Taxes ranked 13 th of 26 factors in importance for investments	
UNIDO (2011)	Covering 2000-2011, 7000 firms in 19 countries	Incentives ranked 11th out 12 location factors; incentives also noted as a "deteriorating" factor over the last 3 years	

Source: James, 2013, at 15-16 and UNIDO.²⁰

The effectiveness of incentives on investors' investment decisions varies based on the nature of the business and its motive for FDI (Table 3).

Table 3²¹: Typology of FDI and response to Tax Incentives

Type of Investment	Factors that drive investment	Response to investment incentives
Resource-seeking FDI	Location of natural resources/raw materials/low-skilled labor/agglomeration benefits	Low response. FDI driven primarily by non-tax factors.
Market-seeking FDI	Market potential <ul style="list-style-type: none"> - Market dimensions - Income per-capita - Customer specific preferences 	Low response. Level playing field between firms is critical (same tax system for all)

¹⁹ Reuber, G., 1973, *Private Foreign Investment in Development*, Oxford University Press.

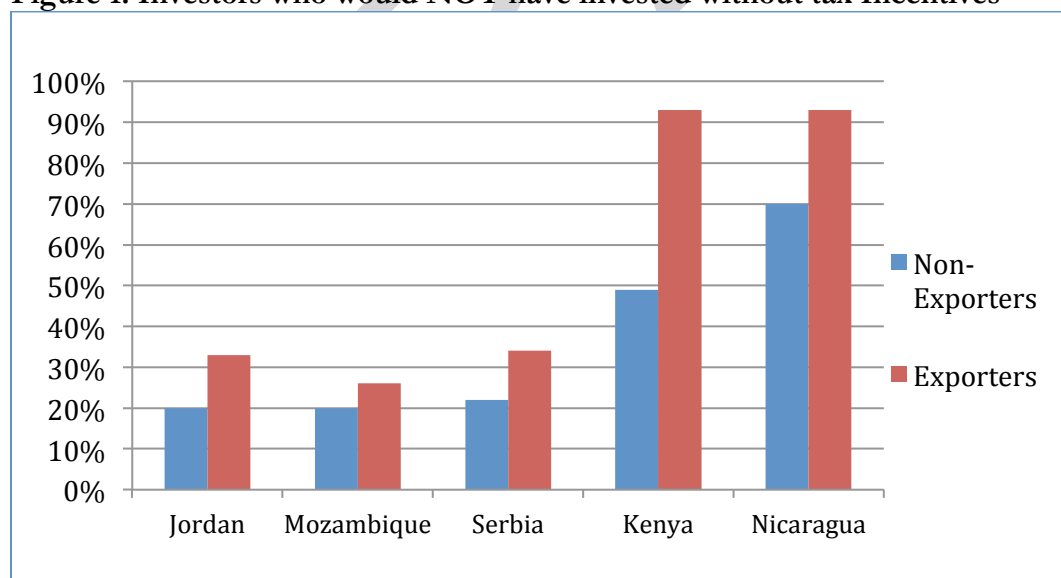
²⁰ UNIDO 2011- Africa Investor Report - Towards Evidence Based Investment Promotion Strategy , http://www.unido.org/fileadmin/user_media/Publications/Pub_free/AIS_Report_A4.pdf

²¹ James, S. 2013, *Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications*. World Bank Investment Climate Advisory Services. September 2013.

	- Kind of goods and services to be provided	competitors).
Strategic-asset-seeking FDI	Acquiring strategic assets <ul style="list-style-type: none"> - Brands and market positioning - Know-how - Technology - Distribution networks - Human capital 	Low response. FDI is driven by the location of the asset. However lower taxes on capital gains reduces the costs of the transfer of these assets.
Efficiency-seeking FDI	Lower costs <ul style="list-style-type: none"> - Mostly export oriented - Availability of skills at low costs - Close to markets - Low relocation costs 	High response to tax incentives. Firms are expected to compete globally, hence the lower the costs, the better their ability to compete globally.

As Table 3 shows, firms engaging in FDI to enter new markets or acquire natural resources (or other resources or strategic assets) appear less motivated by incentives than highly mobile and efficiency-seeking firms intent on reducing costs for products destined for a global, rather than domestic market. (See also Figure 1, showing relevance of incentives for firms engaged in exports as compared to those producing products for domestic consumption).

Figure 1: Investors who would NOT have invested without tax Incentives



Source: James, 2013, at 17.

Similarly, ICA finds that fiscal or other cost-reducing incentives tend to be effective where the investment decision is:

- A decision on where to locate among similarly attractive platforms, which meet underlying project requirements, for producing for export to other markets; or
- A decision on where to locate among similarly attractive parts of one large market (such as the US, EU, and China).

ICA also finds that a firm's receptiveness to investment incentives depends on where it is in its life-cycle, and whether the incentive matches its needs at that time. While, for instance, new start-up projects might prefer incentives that reduce their initial expenses, established firms seeking to expand may prefer tax-related incentives that affect profit. More broadly, firms favour incentives that are transparent and easy to understand, and value certainty in incentives policy. Incentives programs not meeting those criteria will likely be less effective in influencing investment and location decisions.

Yet even where well designed, incentives have their limits, as they are often unable to compensate for unattractive investment environments such as poor infrastructure, legal and economic instability, weak governance, and small markets.

Types of investment incentives

Investment incentives can be broken down into four types: (1) **fiscal/tax incentives**; (2) **financial incentives**; (3) **regulatory incentives**; and (4) **technical or business support incentives**.

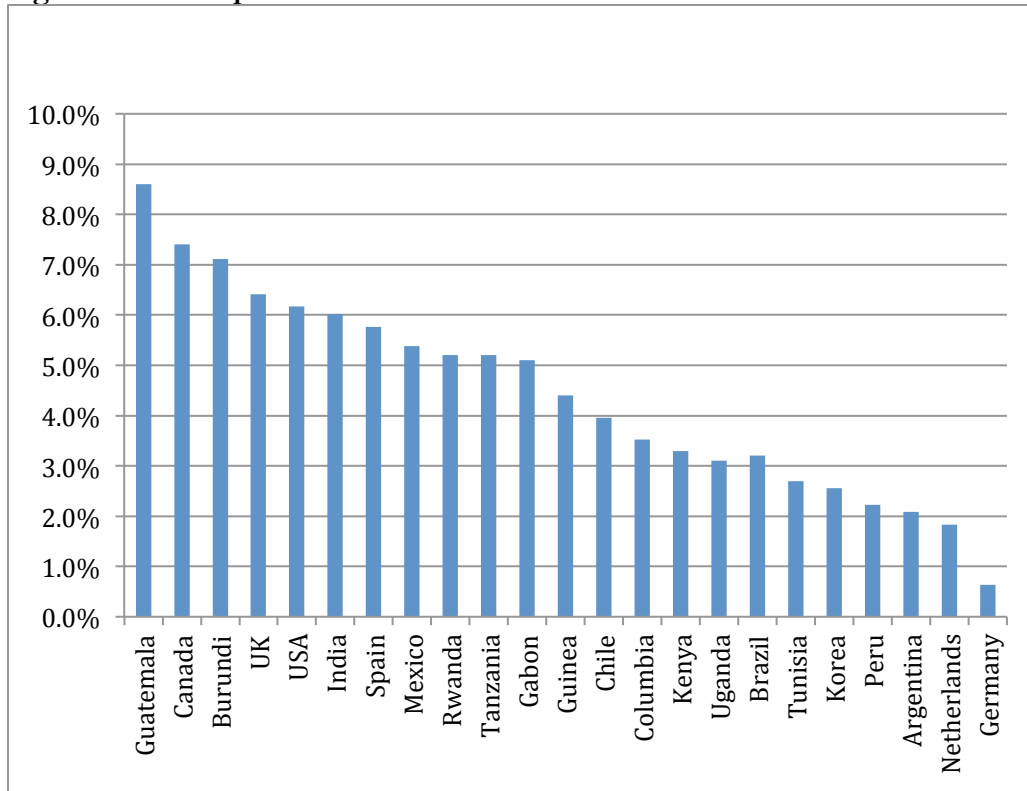
(1) *Fiscal/tax incentives*

Tax expenditures are defined as revenue losses that arise due to concessions that fall outside the regular tax system. Calculation of tax expenditures would cover all the tax incentives such as:

- *Exemptions*: income excluded from the tax base
- *Allowances*: amounts deducted from gross taxable income
- *Credits*: amounts deducted from tax liability
- *Rate relief*: a reduced rate of tax applied to a class of taxpayers or activities
- *Tax deferrals*: relief that takes the form of delay in paying tax (for example, accelerated depreciation)
- *Duty exemptions*: duty not collected on imports that in the usual course would be collected
- *VAT exemptions/Zero-rating*: VAT not collected either on imports/production or value added.

Figure 2 shows the extent of tax expenditures in twenty-two countries, including several OECD countries where it is a common practice to calculate such concessions, and in developing countries where tracking tax expenditures is less common.

Figure 2: Tax Expenditure as % of GDP



Source: James, 2013, at 19 (drawing from OECD, IDB, and World Bank Reports).

(2) Financial incentives

Financial incentives, as well as other non-fiscal instruments, are divided into greater detail below (Table 4). This is a recommended categorization of non-fiscal incentives, capturing the key types of incentives offered across different countries, as compiled by the World Bank Investment Advisory Services.

Only incentives that are aimed at “specific” undertakings are included in Table 4. It thus does not include measures of general applicability such as government expenditures in public infrastructure that, although they might be crucial for attracting investment, are not targeted toward specific investors or investments. Unlike financial incentives, all instruments listed under “other non-fiscal instruments” provide advantages that are difficult to measure.²²

Table 4: Financial incentives and non-fiscal incentives, instruments and examples

²²Special Economic Zones (SEZs) were excluded from the typology here because they involve a unique mix of fiscal and non-fiscal investment instruments.

Instrument		Examples
Financial Incentives	General Financing Incentives Provision of financing options primarily to defray start-up costs, but may also be offered to upgrade or stabilize an investor's operations	Direct Grants and Cost-Sharing Schemes <ul style="list-style-type: none"> • Cash grants on proof of start-up, or after x years of operation • Public sector equity participation
		Lending Instruments and Guarantees <ul style="list-style-type: none"> • Soft loans • Interest subsidies • Loan guarantees
	Land and Infrastructure Incentives Reduced rates on and/or direct provision of land, public utilities, or transportation granted for specific investments	Reduced Market Values or Direct Provision of Land <ul style="list-style-type: none"> • Public land or buildings sold to investors at below market values • Infrastructure provision such as roads, railways, harbors, telecomm
		Low Input Prices From Parastatals <ul style="list-style-type: none"> • Reduced rates on public utilities (e.g. electricity, water) and transportation
	Training and Employment Incentives Subsidized training programs and education commitments or subsidies to reduce investors' staffing costs	<ul style="list-style-type: none"> • Job training subsidies • Wage subsidies • Exemptions from social security contributions
	R&D Incentives Grants and lending instruments to support investments in R&D and innovation	<ul style="list-style-type: none"> • Subsidies supporting R&D and Innovation
Other Non-Fiscal Incentives	Regulatory Incentives Granting exceptions from rules and regulations	<ul style="list-style-type: none"> • Exemptions from environmental regulations
	Set-up Assistance and Aftercare Services to support investors set up and run their operations, often provided by the domestic investment promotion agency	<ul style="list-style-type: none"> • Preferential treatment/Streamlined administrative processing • Administrative and consulting assistance • Relocation and expatriation support

(3) Regulatory incentives

Regulatory incentives are policies of attracting investments “by means of offering them derogations from national or sub-national rules and regulation.”²³ One example is a clause in either a law or contract stating that if the legislation or regulations governing an investment project change in a way that is less favorable to that project, the investment can opt out of those new measures, or can obtain compensation for any additional costs incurred in complying with them.

The Law on Investments of the Kyrgyz Republic contains an example of such a provision, stating that:

If any amendments are made to the investment legislation of Kyrgyz Republic except for the Constitution of Kyrgyz Republic, tax legislation and legislation regarding state security,

²³ OECD, 2003, Checklist for Foreign Direct Investment Incentive Policies, 17

public health and environmental protection, investors shall have the right to opt for more favourable conditions within ten years from the date of approval of such amendments.²⁴

More commonly, these “stabilization” provisions are found in contracts. A 2009 study found that some type of stabilization clause was found in roughly 59% of contracts between investors and non-OECD states, and in approximately 15% of contracts between investors and OECD countries.²⁵

Other regulatory incentives include investment treaties, instruments that can provide covered investors and investments substantive and procedural rights that go beyond what is available in the general domestic legal framework where the investment is made.²⁶

(4) Technical and business support incentives

Technical and business support incentives are usually provided to reduce information asymmetries and administrative hassles and delays, and to make information and necessary assets for production more easily accessible. Provision of these types of non-fiscal incentives is often a central plank of the work done by investment promotion agencies to attract FDI. Previously called “investment-facilitation” services, they are an increasingly important component of promotional activities. Initially they were introduced to increase the efficiency of FDI liberalization owing to bureaucratic barriers reducing its efficacy.²⁷ They usually focus on technical matters relating to dissemination of information on investment opportunities and procedures and providing special services, infrastructure, and “aftercare” once an investor has already invested. Some services might involve financial incentives. In particular, the provision of infrastructure and land at reduced market value is a financial incentive but also a business support or technical services (see “implementation stage” below).

These services can be divided between the key stages of a foreign investment lifecycle as illustrated in Table 5 below.

Table 5: Business support/technical services, by stage of investment

²⁴ Adopted by the Legislative Assembly of Jogorku Kenesh of Kyrgyz Republic February 7, 2003, Art. 2(2).

²⁵ Stabilization Clauses and Human Rights: A research project conducted for IFC and the United Nations Special Representative of the Secretary-General on Business and Human Rights (May 29, 2009), ix.

²⁶ For more on investment treaties, see Section 4.

²⁷ UNCTAD, 1998, at 101.

Phase	Type of service
Decision phase/ Pre-investment stage/ Pre-expansion stage	Information on markets
	Information on availability of supporting infrastructure
	Information on corporate taxation and incentives
Entry stage	Information on strategic partners (distribution, legal support, recruitment support, etc.) and on relevant industry or sector
	Information on procedures and regulations for doing business in this country (company registration, permits, labour regulations, etc.)
	Facilitating company registration, licensing (work permits, import/export permits, etc.)
	Introduction to legal, accounting and other professional services
Implementation stage	Soft landing services (e.g. schools, housing, safety)
	Finding suitable sites (e.g. land, office, factory)
	Facilitating building construction
	Access to utilities and infrastructure
Operation stage/ After care stage	Finding key staff
	Complaint resolution (issues concerning tax, labour, customs, immigration, utilities)
	Information on finance
	Matchmaking (access to suppliers, buyers, finance)
	Assistance in upgrading (information on technology sources, terms of technology transaction)
	Access to utilities and infrastructure

Source: UNIDO (2011)²⁸ based on surveys of African IPAs.

Box 1, below, presents those investment incentives in the particular context of efforts to support *outward* FDI.

Box 1: Outward Foreign Direct Investment (OFDI) Incentives

The outward side has been forgotten

Attention given to FDI incentives has been focused on the inward side, i.e. what support measures can be put in place to attract FDI. There is an aggressive race using incentives as “anabolic steroids” (Oxelheim & Ghauri, 2004) to attract inward investment, based on a broad consensus that such investment and the flow of resources it brings to host countries tends to be positive. Such consensus has not been so strong on the outward side, this being one of the reasons why incentivizing outward FDI has been avoided until recently. Arguments such as exporting jobs and technology, crowding out domestic investment and the like have kept at bay most measures to promote OFDI. Home country measures (HCMs) to stimulate outward internationalization have privileged exports, as the connection between exports, economic growth and opportunities for job creation and technological development in the home country is more evident. Until recently, little attention has been paid to OFDI by the majority of countries (Sauvant, 2008) and some governments even applied measures to restrict or dissuade OFDI, and that provided differential

²⁸ UNIDO 2011- Africa Investor Report - Towards Evidence Based Investment Promotion Strategy, http://www.unido.org/fileadmin/user_media/Publications/Pub_free/AIS_Report_A4.pdf

treatment between inward and outward FDI.

However, this is changing fast, and many countries now believe that incentives to OFDI are appropriate and efficient, leading governments to be proactive on this front. This happens as countries realize that domestic companies need to be competitive in the global arena, hence must gain scale and conquer new markets in more ambitious ways. This is particularly true for small and medium firms (SMEs), which are the majority of companies in most countries. OFDI is also a means of gathering and internalizing knowledge and improving innovative performance and, in this more benign view, a vehicle for the growth and long term domestic welfare of regions and countries. It is a risky and demanding activity, involving qualified human capital and considerable financial and other resources. A trend worth noting is the recent exponential increase in OFDI from emerging economies. Strong government support measures have been associated with this growth, and the spread of OFDI incentives has occurred throughout all geographies. This has led to controversy and to concerns about competitive neutrality (Economou & Sauvant (2013)).

What types of OFDI incentives exist? How do they differ from those on the inward side?

There are different typologies to categorize OFDI incentives/policies. OECD (2003) distinguishes 3 types: financial, regulatory and fiscal. Economou & Sauvant (2013) provide another classification: (i) institutional framework; (ii) information services; (iii) financial measures; (iv) fiscal measures; (v) investment insurance measures; (vi) treaties. Here, we propose the following 5 categories:

	Outward FDI HCMs	Differences with inward FDI
Financial	Monetary transfers – cash or subsidies. Grants, loans (preferential access to credit and/or low interest) and even equity participation on investment projects (UNCTAD, 2001).	No obvious difference, although the object of the loans is likely to be very different (e.g. on the outward side loans may be offered to enable acquisitions; this would be politically unpopular in terms of inward FDI).
Fiscal	Tax breaks/exemptions, rate reductions, tax deductions, loss carry forwards, deferrals, accelerated depreciation, customs benefits (Coelho, Tavares-Lehmann & Lehmann, 2012).	Fully-fledged and long tax breaks are more common on the inward side; tax deductions are common on both sides. Aggressive tax policies may occur on both sides.
Information and technical services	Information on markets and operations (economic data, information on industry and on other stakeholders—competitors, suppliers, clients, partners, entities from the scientific/ technological system, global value chains,	Important and very common on both sides, but probably more critical for outward investors.

	costs, skills, availability of distinct resources, identification of opportunities, other business intelligence; services such as feasibility research, legal support, skill training programs, consulting activities, international exchange programs for human resources, support to trade fairs and missions, etc.	
Risk-minimizing measures	Political risk insurance and credit risk insurance. The former protects against political upheavals, risks of expropriation/nationalization, guarantees against adverse changes in legislation, in terms of damages' compensation, war and repatriation. The latter relates to failure of clients to honor their payments.	Not so applicable on the inward side. Such risk may be mitigated by treaties, and countries signal that they are stable when signing international investment agreements and treaties.
Others	Regulatory (enacting investment agreements, double taxation treaties) and others - improving the investment climate (reducing bureaucratic circuits and facilitating processes; establishing protocols with multiple entities in order to facilitate investment).	Totally different. On the inward side, measures like infrastructure improvement and offering land and buildings in specific locations are often used. Such measures are often not very transparent. In OFDI these measures are not easily applicable.

Probably the most critical difference *vis-à-vis* the inward side is that home countries have, by definition, less control of the host environment and associated stakeholders and locational attributes. Thus, the home country is more constrained (or even powerless) in the ability to change some of these factors. At home, they are naturally more powerful and have a better hold of relevant FDI-related determinants. E.g., the home country government cannot change several relevant aspects pertaining to the investment decision and its profitability/performance (labor laws, the bureaucratic circuit to be followed, the granting of favorable or exceptional positive discrimination measures, etc.). However, if the home country is very influential *vis-à-vis* the host economy, then there is potential for influencing the latter's strategy. But it is still not the same as being in one's own jurisdiction.

At the institutional level, the 'one stop shop' approach that is often tried on the inward side, does not appear usually on OFDI. It is more difficult to discern extant OFDI support measures, given that implementation tends, in contrast to what happens in inward FDI attraction, to be fragmented between several entities (i.e. the one giving fiscal incentives, the one offering financial support, the one making agreements with the banks/mutual guarantee agencies, the one that provides

information & technical assistance, that negotiating the treaties and investment agreements, etc.). All this, together with the comparative lack of experience in their design and implementation, renders the task of conceiving and putting into practice OFDI policies more complex than what concerns their inward-focused counterparts.²⁹

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Section 2: An overview of global investment and foreign direct investment incentives

The widespread use of investment incentives is not a new phenomenon. In 1995, UNCTAD's World Investment Report presented a comprehensive survey of 103 countries' practices relating to their use of those tools. The survey found that incentives were generally offered both to foreign and domestic firms, were pervasively used in a range of countries and regions, and favored a variety of industries, with activities involving high-value added and technology appearing to be a growing target.

Among the types of incentives, UNCTAD found fiscal incentives to be widely used, with all but 4 of the 103 countries surveyed having offered those advantages in the early 1990s. Changes in the corporate income tax rate were the most common in that category (offered by 83 out of 103 countries), "followed, in declining order of importance, by tax holidays, exemptions from import duties, duty drawbacks, accelerated depreciation, specific deductions from gross earnings for income tax purposes, reinvestment allowances and deductions from social security contributions."³⁰

Financial incentives appeared to be less common overall, offered in at least 59 out of the 83 countries analyzed in that part of the study. They were relatively more important in advanced economies than in developing countries, and were often offered as grants – incentives that are both visible and relatively easy to administer.

Regulatory incentives were also significant. In developing countries and in Central and Eastern Europe, protection from import competition and preferential allocation of foreign exchange were among the policy tools used to attract investors. Countries were similarly permitting foreign

²⁹ Economou P. & Sauvant K., (2013), FDI, Home Country Measures and Competitive Neutrality, Ch.1, *Yearbook On International Investment Law & Policy 2012–2013*, Oxford University Press; OECD (2003). *Checklist for Foreign Direct Investment Incentive Policies*. Paris: OECD; Oxelheim, L. & Ghauri, P. (eds.) (2004), *European Union and the Race for Foreign Direct Investment in Europe*, Elsevier; Sauvant, K. (2008), *Outward FDI From Emerging Markets: Some Policy Issues*, in Dunning J.H & Gugler, P. (eds), *Foreign Direct Investment, Location and Competitiveness*, Progress in International Business Research, Vol. 2, 279–284, Emerald; Tavares-Lehmann, Coelho & Lehmann, F. (2013) *Taxes and Foreign Direct Investment Attraction: A Literature Review*, in Van Tulder, R., Verbeke, A. & L. Voinea (eds), *New Policy Challenges for European Multinationals*, Progress in International Business Research, Vol. 7, 89-116, Emerald; UNCTAD (2001), *Trade and Development Report 2001*, New York and Geneva: UNCTAD.

³⁰ UNCTAD, *World Investment Report 1995: Transnational Corporations and Competitiveness*, p. 295.

investors to maintain offshore accounts in which they could hold foreign exchange proceeds from insurance contracts, export sales, and other authorized transactions, thereby making “it easier to secure investment insurance, and offer[ing] protection against the risks of local currency devaluation, non-convertibility and unfavourable exchange rates.”³¹

Various countries had added the provision of business facilitation, technical services and infrastructure to their policy toolboxes. Some of these incentives focused on subsidized training, information provision, and subsidized technical assistance: “institutional arrangements for the provision of information, consultancy and management services, as well as training and other technical assistance at subsidized prices or zero cost were increasingly becoming a common form of incentive in many countries, often focused on small firms, technology transfer and regional problem areas.”³² Countries – particularly developing countries – were also establishing special economic zones (SEZs) offering subsidized and dedicated infrastructure and services to enterprises investing in them.

Surveys conducted by UNCTAD (1998, 2000)³³ and Oman (2000)³⁴ updated the above findings.³⁵ In a 1998 report, UNCTAD concluded that an increasing number of countries were targeting investment activity in industries involving technology and high value-added (such as electronics, robotics, computer software) and in infrastructure projects.³⁶ The surveys also looked into the effectiveness of those measures, noting that export-orientated investors valued fiscal incentives; market-seeking investors market protection (such as exclusive licensing agreements); and regional investors financial incentives, in particular grants. Oman (2000) found the use of FDI incentives to be more intense in certain industries (in particular the automobile industries) and for large or high profile projects. Additionally, he examined the issue of incentive-based competition, and concluded that most was intra-regional.

Other more recent studies presented in the following section include those carried out by the World Bank Advisory Services focusing on non-financial incentives (see Box 2 below); research conducted by the United Nations Industrial Development Organization (UNIDO) and the Asian Development Bank during 2010-2011 looking respectively at incentives offered in Africa and Asia; data collected and published by the European Competition Commission on State aid of the European Union; and information collected by private entities, individuals and organizations such as ICA, Professor Kenneth P. Thomas, and the Pew Center on the States.

The data presented in this section uses those sources and others to illustrate patterns and practices regarding the use of incentives in countries in different regions of the world, including (1) information on State aid in Europe; (2) incentives offered in the US; (3) incentives offered in Eastern Africa; (4) incentives offered in Asia; and (5) incentives offered in Latin America.

³¹ Id. at 298.

³² Id.

³³ UNCTAD, World Investment Report 1998: Trends and determinants; UNCTAD, World Investment Report 2000: Cross-border Mergers and Acquisitions and Development.

³⁴ Charles Oman, 2000 - Policy Competition and Foreign Direct Investment - OECD Development Center.

³⁵ See also Judith Gergely, Trends in Foreign Direct Investment Incentives (May 2003), available at: http://www.ause.it/wp/5_wp.pdf.

³⁶ UNCTAD, World Investment Report 1998: Trends and determinants, p. 103.

Yet the data also reflects the key challenge for research on these issues: the lack of transparency. In general, the figures from the EU provide a relatively comprehensive set of information regarding use of incentives. This is due to requirements for member states to report subsidies and the public disclosure of reported information. While EU State aid data does not capture all incentives offered by EU member states, nor incentives granted by the EU's institutions, its reporting requirements, their enforcement, and the public release of the information is, however, unique as compared to other regions of the world. Apart from the EU and efforts by some sub-national entities, information regarding the use of incentives – e.g., what is being provided, who is granting incentives, for what type of investment to what investor, and at what aid intensity – is not systematically collected or disclosed, hindering research and analysis of policy issues and solutions.

Box 2: World Bank findings on non-fiscal incentives (NFIs)

- The World Bank Investment Advisory conducted research on non-fiscal incentives (which include financial incentives) across 13 countries: four high-income OECD countries (Belgium, Austria, France Czech Republic); four upper-middle income countries (South Africa, Turkey, Argentina, Bosnia and Herzegovina); two lower-middle income countries (India and Morocco); and three low-income countries (Sierra Leone, Kenya, and Haiti). The key trends observed are described below.

Selection of NFI Instruments

- The application of NFIs is widespread, and the diversity of different NFI instruments is especially pronounced in middle- and high-income countries. Still, the majority of NFIs across high- and middle-income countries are provided in the form of financial incentives.
- Low-income countries tend to rely more heavily on fiscal incentives, likely because the up-front budgetary impact of deferred or forgone tax revenue is much smaller than the payouts required for financial incentives.

Policy Objectives and Implementation Approaches

- NFI strategies may be (i) regionally-oriented, (ii) focused on developing prioritized areas/activities or (iii) applied to support certain industries.
- In middle- and high-income countries, there is an emphasis on promoting strategic sectors and high-growth activities.
- With some exceptions, in middle- and high-income countries, the eligibility criteria for incentives rarely discriminate between foreign and national investors. That said, in practice, foreign enterprises may be better positioned to acquire certain incentives because they are more flexible in location choice, are more apt to conduct R&D, invest in strategic sectors, etc.
- In middle- and high-income countries, the main types of policy objectives relate to:
 - Job creation/retention;
 - Promotion of strategic or priority sectors;
 - Development of human resources;

- Supporting R&D and the transfer of technology;
 - Encouraging investment in less developed areas within a country; and
 - Supporting the growth of SMEs.
- The incentives awarded to industries of high added value production tend to be more substantial than those awarded to other industries.
 - Low-income countries appear more likely to adopt “specific” incentive approaches tailored to individual investors/projects. They are more likely to offer incentives on a case-by-case basis.
 - Some countries (e.g. Austria) have very targeted investments such as those that focus exclusively on technology R&D or the growth of SMEs.
 - Countries that are loosely acknowledged to have achieved success with their investment schemes in the investment policy literature (e.g. Austria and Czech Republic) tend to focus on projects that prioritize (i) staff training (human resources), (ii) the diffusion of technology, and (iii) the development of lesser developed regions.

General Considerations on the Role of NFIs

- In both developed and emerging countries, NFIs are adopted by governments as a supplementary attraction factor primarily to incentivize an investor who may already be wavering between like options, or to compensate for market failures and improve market conditions.
- Since there are many forms by which NFIs can lead to wastefulness (e.g. forgone opportunities, offering compensation for investors who would have invested regardless of the incentive regime, spurring a “race to the bottom,” etc), the cost and benefits need to be carefully assessed before implementing NFI instruments.
- Different NFI instruments have inherent advantages and disadvantages that may render certain incentives better suited to promote policy objectives in different host contexts.

Source: World Bank Investment Advisory (2013)

European Union self-reported data

The information below is based on the data compiled by the European Competition Commission on State aid.

State aid regulated by EU law is (Article 107(1)): (1) aid, in any form whatsoever, which confers an advantage or benefit for the recipient; (2) granted by a Member State or through State resources; (3) that distorts or threatens to distort competition by favoring certain undertakings³⁷ or the production of certain goods; and (4) affects trade between Member States. All four elements must be met in order for government assistance to count as State aid. (More in the Box 3 below and Section 4)

Box 3: Key concepts and definitions in EU regulation of State aid:

Aid intensity: A measurement of aid that looks at the amount of the aid as a percentage of the total investment. EU rules require calculation of aid intensity in terms of “gross grant equivalents”, or the discounted value of the aid expressed as a percentage of the discounted value of specified eligible investment costs. Under EU regulations, the permissible level of aid intensity varies based on the economic conditions in the jurisdiction granting incentive. The more disadvantaged states and regions are able to provide incentives at a higher degree of aid intensity than the less disadvantaged states. If an incentive is being used to support a small- or medium- sized enterprise, the permissible aid intensity will rise; but if the incentive is used to support a “large investment project” the permissible aid intensity will drop. The European Commission develops specific guidelines to determine allowed aid intensities.

Form of aid: The form of State aid is variable. It may, for example, take the form of grants, low-interest loans or interest rebates, state guarantees, the purchase of a share-holding or an alternative provision of capital on favorable terms, exemptions or reductions in taxes, social security or other compulsory charges, or the supply of land, goods or services at favorable prices.

Horizontal aid: Aid used to pursue objectives of common interest in accordance with Article 107(3) of the Treaty on the Functioning of European Union (TFEU). It includes aid for pursuit of environmental goals; research, development and innovation; employment and training; and support of small- and medium-sized enterprises. States granting such aid can use different tools such as reporting requirements and claw-back provisions to ensure that aids are use to support the intended policy objective.

³⁷ An undertaking is any entity (this includes legal persons, such as a company, and individuals acting as sole traders) which is engaged in an economic activity (C-303/88 Italy v Commission 1991 ECR I-1433). An economic activity is “any activity consisting of offering goods and services on a given market” (C35/96 – Commission v Italy 1998 ECR I-03851). When an organization is carrying out an activity for which it is capable of being remunerated and competing against other organizations within a market, it will be an undertaking for the purposes of State Aid. The Commission applies the undertaking test very narrowly. It does not take into account whether a fee is charged or whether the amount of profit is appropriate. Neither does it consider whether the organization has charitable aims or other social objects. Public sector organizations that have engaged in an economic activity have been found to be undertakings. (Italy v Commission, 1991 ECR I-1433)

Non-crisis State aid: This is State aid that excludes measures aimed at supporting the financial sector, aiding recapitalization and providing impaired asset relief in relation to the financial crisis. Following EU methodology adopted in order to avoid distorting the picture of trends, the discussion in this report excludes crisis aid unless otherwise stated. The EU’s methodology for calculating non-crisis State aid also excludes subsidies to the railway sector and aid for services of general economic interest (SGEI).

Investment aid v. operating aid: Investment aid is “aid awarded for investment in material and immaterial assets relating to the setting up of a new establishment, the extension of an existing establishment, diversification of the output of an establishment into new, additional products, or a fundamental change in the overall production process of an existing establishment.” Operating aid is regional aid used to reduce a firm’s current expenses (e.g., tax exemptions or reductions in social security contributions). Because operating aid is not considered to be tied to new investment, job creation, or general development, it is only rarely permitted.

Regional aid: This category of State aid is granted to promote the economic development of certain disadvantaged regions within the European Union. It consists of (1) investment aid granted to large companies in designated areas or, in specific limited circumstances, operating aid; and (2) investment aid to small- and medium-sized enterprises within disadvantaged regions that exceeds what is allowed in other areas. The amount of aid permitted depends on the degree to which the region is disadvantaged relative to other areas of the EU, or relative to the national average.

Regional aid maps: These are used to determine the regions that are eligible for regional investment aid and the maximum aid intensities for those regions.

Source: Report from the Commission: State Aid Scorecard: Report on State Aid Granted by the EU Member States, Autumn 2012 Update (Dec. 21, 2012), available at: http://ec.europa.eu/competition/state_aid/studies_reports/2012_autumn_en.pdf [hereinafter “EU Scorecard”]

Data reported by EU member states indicate that use of non-crisis State aid is declining in the EU, likely due to the implementation and enforcement of regulations on State aid (those regulations are described further in Section 4). In 2011, non-crisis State aid amounted to roughly 0.5 percent of GDP, having dropped from approximately 2 percent in the 1980s.³⁸ Of that amount, .42 percent of was dedicated to industry and services, .07 percent to agriculture, .001 to fisheries, and .02 to transport. In terms of absolute value, most non-crisis State aid to industry and services is granted by Germany (€13.6 billion), France (€12.3 billion), the United Kingdom (€4.8 billion), Spain (€4.5

³⁸ These numbers only cover State aid reported by 27 of the 28 EU member states. Croatia is excluded because it only became an EU member in 2013.

billion) and Italy (€3.8 billion). As a percentage of GDP, the largest granters are Malta (1.6%), Greece (1.2%), Finland (1.2%), Hungary (1.1%) and Slovenia (1.1%).³⁹

Within that overall downward trend, EU rules have also produced a shift toward the use of horizontal aid, which now accounts for 90% of all non-crisis State aid to industry and services, with sectoral aid accounting for the remaining 10%.⁴⁰ In some states, the share of horizontal aid is lower, but in only a few does it fall below 50%.⁴¹ This shift toward use of State aid for horizontal purposes reflects a greater use of incentives to address market failures and pursue specific, previously-identified goals important to the EU as opposed to more generally encouraging new or supporting existing investment in a given sector or industry.

As in previous years, the three main horizontal objectives in 2011 for which member states granted aid were (1) regional development, (2) safeguarding the environment including fostering energy saving and promoting the use of renewable energies, and (3) research, development and innovation (“R&D&I”). Regional development aid accounted for 26% of non-crisis State aid to industry and services, followed by environment (23%) and R&D&I (19%).⁴² Aid to SMEs (4.6%) and aid for generating employment (2.7%) and promoting training (1.5%) were less used by member states.⁴³

Most non-crisis State aid provided by member states to industry and services, as shown in Table 6, is given through grants (57% in 2011 in terms of value), followed tax exemptions (36%). Falling well behind those categories are soft loans (3%), guarantees (3%), equity participation (0.2%), and other forms of aid (0.1%). Those breakdowns, however, vary between countries and based on the objective of the aid. Over the 2009-2011 period, Greece, for example, provided aid mostly through guarantees (52%), while Portugal gave the vast majority (92%) through tax reductions. With respect to the relationship between aid-type and objective, most aid dedicated to environmental purposes comes through tax exemptions (73% between 2008-2011), while aid for R&D&I is typically through grants (80% from 2008-2011).⁴⁴

Table 6: Non-crisis aid to industry and services by aid instrument and by member state, annual average in million EURO, 2009-2011.

	Grants	Tax reduction (incl. tax deferral)	Equity participation	Soft loans	Guarantees	Total
EU-27	32393	23903	602	1895	1255	60048
Belgium	981	625	9	61	1	1677

³⁹ EU Scorecard, at 6.

⁴⁰ As indicated in the text, these numbers do not include crisis aid, nor aid to agriculture, fisheries, or transport. .

⁴¹ EU Scorecard, at 8.

⁴² European Commission, Commission Staff Working Document: Facts and figures on State aid in the EU Member States, 2012 Update (Oct. 12, 2012), at 11 [hereinafter “Commission Staff Working Document on State Aid, 2012”].

⁴³ Id.

⁴⁴ Id.

Bulgaria	18	7	0	0	0	25
Czech Republic	753	113	0	6	100	972
Denmark	1139	60	6	9	1	1215
Germany	8245	5289	29	201	76	13840
Estonia	13	3	0	0	0	16
Ireland	325	439	2	30	0	796
Greece	825	117	0	0	1013	1955
Spain	2498	984	0	740	7	4229
France	4971	6458	14	328	14	11785
Italy	3147	383	20	226	11	3787
Cyprus	84	2	0	0	0	86
Latvia	36	15	1	1	0	53
Lithuania	95	13	1	0	0	109
Luxembourg	90	0	0	1	0	91
Hungary	803	488	1	24	5	1321
Malta	38	98	0	0	0	136
Netherlands	1461	315	6	18	10	1810
Austria	1407	222	2	54	12	1697
Poland	1777	747	17	38	1	2580
Portugal	190	2603	14	19	0	2826
Romania	219	2	4	3	0	228
Slovenia	308	6	1	2	0	317
Slovakia	115	106	0	0	0	221
Finland	550	294	19	34	3	900
Sweden	442	2356	2	5	0	2805
United Kingdom	1863	2157	452	96	1	4569

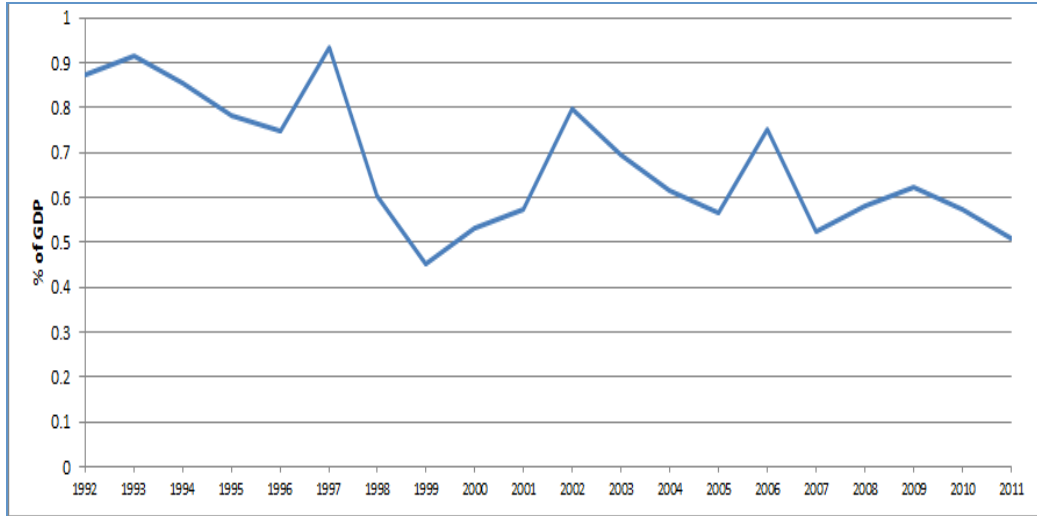
Source: DG Competition (2012).⁴⁵

In addition to overall declines in the amount of State aid provided, the “intensity” of the aid has also shrunk.⁴⁶ As is discussed further in Section 4, this is due to EU rules placing ceilings on permissible levels of aid intensity. Areas that are the most disadvantaged and in need of investment have the highest ceilings. The ceilings are further lowered for investment in large projects (i.e., projects with eligible expenditures greater than €50 million), but raised for investments by small- and medium-sized enterprises.

Figure 3: Total non-crisis State aid as a percentage of GDP, EU-27, 1992-2011

⁴⁵ http://ec.europa.eu/competition/state_aid/studies_reports/expenditure.html#3.

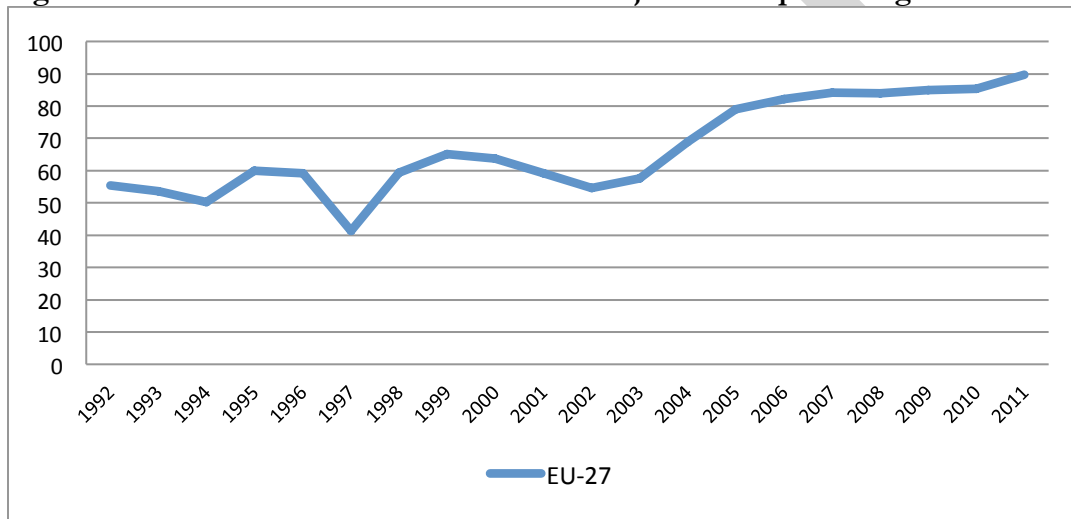
⁴⁶ Thomas, K.P., 2011, *Investment Incentives and the Global Competition for Capital*. Palgrave Macmillan: USA, Ch. 8, at 10.



Source: DG Competition.⁴⁷

Note: Total aid excludes railways. Data for Austria, Sweden and Finland are included from 1995 onwards, for EU-10 member states from 2000, for Bulgaria and Romania.

Figure 4: Non-crisis State aid for horizontal objectives as percentage of total aid (1992-2011)

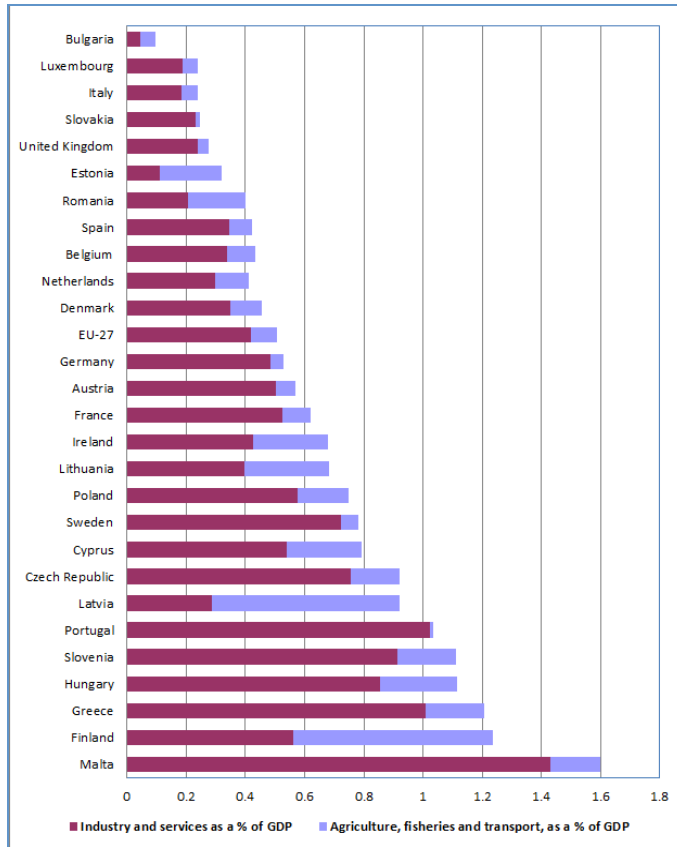


Source: Authors based on DG Competition.⁴⁸

Figure 5: Total non-crisis State aid as a percentage of GDP by Member State, 2011

⁴⁷ http://ec.europa.eu/competition/state_aid/studies_reports/expenditure.html#3.

⁴⁸ http://ec.europa.eu/competition/state_aid/studies_reports/expenditure.html#3.



Source: DG Competition, DG Agriculture and Rural Development, DG Fisheries and Maritime Affairs.⁴⁹

Table 7: Non-crisis State aid for horizontal objectives and sectoral aid as a % of total aid (last column in absolute terms), 2011

	Horizontal objectives								Sectoral aid					Total aid for industry and services (€ million)	
	Total of horizontal objectives	Environment	Regional development	Research, development and innovation	SME	Training	Employment aid	Other horizontal objectives (e.g. culture, natural disaster, social aid etc.)	Total Sectoral Aid	Coal	Financial Services	Manufacturing Sectors	Other Non Manufacturing Sectors		Services
EU-27	90	23	26	19	6	1	3	11	10	4	2	1	1	1	52964

Source: DG Competition⁵⁰

Note: All columns are in % except for the final column.

⁴⁹ http://ec.europa.eu/competition/state_aid/studies_reports/expenditure.html#3

⁵⁰ http://ec.europa.eu/competition/state_aid/studies_reports/expenditure.html#3.

The following section examines ICA database⁵¹ for a different look into the incentives practices of one Western European Country (the UK) and one Eastern European Country (the Czech Republic).⁵² The numbers presented below diverges from the State Aid information presented above because the ICA data (1) covers a different period, (2) is narrower than State aid in that only captures specific incentives deals that lead to job creation and capital expansion and (3) is broader than State aid in that it does not require an incentive to meet the elements of the “State aid” definition (i.e., it does not require that the aid be trade distorting or affect trade with other EU member states).

⁵¹ The database uses publicly available reports by governments, companies and the media to capture the take-up of “incentive deals” by firms as well as incentive programs (policies) offered by governments. There are programs and non - programs incentives, with the second category corresponding to discretionary incentives. “Unspecified” incentives deals capture ad hoc or discretionary incentives, but may also include deals done in accordance with established government policies or programs. The incentive deals captured relate to taxes, grants, loan and undisclosed incentives *but only if those deals can be associated with job creation and physical expansion*. The methodology is further described in Appendix 2.

⁵² This section presents information collected in the ICA database regarding use of incentives in both FDI and non-FDI deals. An FDI deal is when the company receiving the incentive is not from that country. A non-FDI deal is when the company is resident in the country whose government is awarding the incentive. Data on the incentive deals below are recorded from October 2011 and October 2013. All sectoral and business function incentive deal data are based on information captured between January 2010 and October 2013.

UK investment deals – ICA database 2013

Incentive Programs vs Unspecified Incentive deals (Oct 2011 - Oct 2013)

Number of Deals

UK	FDI	Domestic	Total
Named program	63	273	336
Unspecified program	35	52	87
Federal (National)	1	6	7
State (Province)	33	41	74
Local (City, County)	1	5	6
Total	98	325	423

Incentive Value (US\$M)

UK	FDI	Domestic	Total
Named program	250.78	298.54	549.32
Unspecified program	105.37	60.85	166.22
Federal (National)	14.55	18.33	32.88
State (Province)	90.74	40.31	131.05
Local (City, County)	0.08	2.03	2.11
Total	356.15	359.39	715.54

Jan 2010 - Oct 2013

Top 5 Sectors (Jan 2010 - Oct 2013)

Number of Deals

UK	FDI
Information Technology & Tel Services	30
Basic Materials / industrial Goods	24
Automotive	21
Life Sciences	17
UK	Domestic
Industrial Goods	101
Consumer Goods	77
Services	75
Food & Drink	64
Information Technology & Tel Services	50

Incentive Value (US\$M)

UK	FDI	Mean
Automotive	274.3	13.06
Aerospace, Defence and Services	93.36	7.78
Renewable Energy	73.66	14.73
Information Technology & Services	69.65	2.32
Services	62.78	2.51
UK	Domestic	Mean
Services	99.6	1.32
Basic Materials	89.45	1.86
Aerospace, Defence and Services	73.3	2.09
Food & Drink	55.13	0.86
Life Sciences	53.34	1.72

Top 5 Business Functions (Jan 2010 - Oct 2013)

Number of Deals

UK	FDI
Manufacturing	99
Business Service	30
RDD	29
IT Support Center	9
HQ / Call Center	6
UK	Domestic
Manufacturing	328
Business Service	113
RDD	66
HQ	25
Construction & Infrastructure	19

Incentive Value (US\$M)

UK	FDI	Mean
Manufacturing	408.46	4.13
RDD	228.85	7.89
Business Services	56.76	1.89
IT Support Center	20.2	2.24
Warehousing and Distribution	19.96	9.98
UK	Domestic	Mean
Manufacturing	334.74	1.02
RDD	112.05	1.69
Business Services	73.36	0.64
Construction & Infrastructure	39.21	2.06
HQ	38.06	1.52

Source: www.ICAINcentives.com by Investment Consulting Associates (ICA) -2013.

Czech Republic investment deals – ICA database 2013

Incentive Programs vs Unspecified Incentive deals (Oct 2011 - Oct 2013)

Number of Incentive Deals

Czech Republic	FDI	Domestic	Total
Named program	61	20	81
Unspecified program	0	1	1
Federal (National)	0	1	1
State (Province)	0	0	0
Local (City, County)	0	0	0
Total	61	21	82

Incentive Value (US\$M)

Czech Republic	FDI	Domestic	Total
Named program	658.36	108.46	766.82
Unspecified program	0	6.16	6.16
Federal (National)	0	6.16	6.16
State (Province)	0	0	0
Local (City, County)	0	0	0
Total	658.36	114.62	772.98

Top 5 Sectors (Jan 2010 - Oct 2013)

Number of Deals

Czech Republic	FDI
Automotive	27
Basic Materials	15
Consumer goods	7
Industrial Goods	7
Electronics	7
Czech Republic	Domestic
Industrial Goods	8
Basic Materials	5
Automotive	5
Consumer Goods	4
Services	3

Incentive Value (US\$M)

Czech Republic	FDI	Mean
Automotive	424.96	15.74
Basic Materials	139.78	9.32
Electronics	40.14	5.73
Consumer Goods	38.9	5.56
Industrial Goods	40.8	5.83
Czech Republic	Domestic	Mean
Industrial Goods	51.42	6.43
Consumer Goods	24.12	6.03
Basic Materials	21.95	4.39
Automotive	17.76	3.55
Services	6.88	2.3

Top 5 Business Functions (Jan 2010 - Oct 2013)

Number of Deals

Czech Republic	FDI
Manufacturing	69
RDD	4
Shared Service center	4
Business Services	1
Czech Republic	Domestic
Manufacturing	20
RDD	6
Business Services	2
Shared Service center	1

Incentive Value (US\$M)

Czech Republic	FDI	Mean
Manufacturing	705.81	10.23
RDD	85.03	21.26
Shared Service center	7.88	1.97
Business Services	2.93	2.93
Czech Republic	Domestic	Mean
Manufacturing	114.53	5.73
RDD	10.05	1.67
Business Services	5.76	2.88
Shared Service center	1.12	1.12

Source: www.ICAINcentives.com by Investment Consulting Associates (ICA) -2013.

Comparing UK and Czech Republic data

Several points of convergence and divergence emerge from the ICA's data on and the UK and Czech Republic.

Table 8: Comparative overview of investment incentive deals for UK and Czech Republic 2010-2013 (US \$)

	UK	Czech Republic
Avg Value of Incentives	\$3.41m	\$8.61m
% Capex ⁵³	15%	36%
Avg New Jobs per Deal ⁵⁴	79	110
Avg Incentive Value per Job ⁵⁵	\$20,288	\$67,088

Source: www.ICAINcentives.com by Investment Consulting Associates (ICA) - 2013

FDI and domestic deals for “named” vs. “unspecified” deals. In the Czech Republic, FDI incentive deals accounted for the majority of investment incentive deals concluded while in the UK they were fewer than domestic incentive deals (deals done with resident firms). In monetary terms, however, total FDI incentive deals concluded were larger than domestic deals for “unspecified” schemes in the UK (the aids that are ad hoc or for which program detail is not recorded). In contrast, there were no unspecified schemes for FDI in the Czech Republic and only a few of them for domestic deals.

When comparing the average deal value: In the Czech Republic FDI incentive deals were double that of domestic incentive deals. Similarly, in the UK “named program” incentive deals were more than four times larger when given to a foreign firm and for “unspecified” programs they were three times larger when given to foreign firms.

Administration Level. In the UK, the vast majority of deals and funding is at the sub-national level, reflecting the provision of incentives by the nine administrative regions of England, but also Northern Ireland, Wales, Scotland, Guernsey, Isle of Man and Jersey.

Incentive values. Table 8 (above) compares average incentive deal values across the countries. Incentive deals are largest in the Czech Republic at US\$ 8.61 million on average, and smallest at US\$

⁵³ In addition to tracking the amount and type of incentive granted, ICA collects information relating to the potential benefits of the investment project. This includes data estimating the number of new jobs (companies are usually given a deadline by when they must create new jobs by); safeguarded jobs (jobs that companies have pledged to retain as a result of the investment project); and capital expenditure (“capex” – i.e., the total investment being made by the investing company, which usually represents building and equipment costs, rent, and relocation costs). Estimates used for those figures on new and existing jobs, as well as capital expenditures, are generally based on projections provided by the relevant investing company.

⁵⁴ Same as footnote 54

⁵⁵ Same as footnote 54

3.41 million in the UK. In the UK the total amount spent on incentive deals was US\$ 715.5 million, and in the Czech Republic, a slightly greater amount, US\$ 772.98 million.

Form of aid. ICA reports that the most common incentive is cash grants for the UK but tax credits only for the Czech Republic.

Sectors.⁵⁶ The value of FDI incentive deals is highest for the automotive sector in both the UK and the Czech Republic. In the Czech Republic, incentive deals in the automotive sector also account for the largest number of deals and the highest mean incentive deal value out of all FDI deals. In the UK, however, the automotive sector is fourth on the number of deals, with other sectors such as services and advanced industrial goods being targeted as well; in terms of the mean incentive deal value, the UK automotive sector is a close second to renewable energy. Unlike the UK, the Czech Republic, after automotive, is more focused on consumer goods and basic materials investments. For domestic investment, industrial goods investment accounts for the majority of incentive deals in the Czech Republic, while in the UK it is services and basic materials.

Business functions. For the UK and Czech Republic, manufacturing accounts for the majority of incentive deals, ranging from 59% in the UK, to 70% in Czech Republic. In the Czech Republic, manufacturing was more prominent in FDI deals than in domestic deals while in the UK FDI and domestic manufacturing deals account for a similar percentage. “Business Services” accounts for the second most common Business Function of investment incentive deals in the UK, for both foreign and domestic firms while in the Czech Republic those services are much less prevalent, being last and second to last for FDI and domestic deals respectively. RDD also features prominently for both countries across both foreign and domestic investment deals, although at a significantly higher value for the UK.

Incentive intensity and aid per job: The incentive intensity is significantly greater in the Czech Republic (roughly 36%) than it is for the UK (approximately 15%), measured in terms of amount of the incentive compared to the reported capital expenditures. Similarly, the amount of aid per job created is about three times higher in the Czech Republic (US\$ 67,088) than in the UK (US\$ 20,288), with the Czech Republic getting a larger number of jobs per deal (though with a much smaller number of deals and jobs overall⁵⁷).

⁵⁶ The typology of industries and their sectors can be found in Appendix 2.

⁵⁷ 61,849 jobs for UK and 12,764 jobs for Czech Republic over the period from January 2010 to October 2013.

Incentives in the US - ICA Investment deals database⁵⁸

In the US, where there is significant inter- and intra-state competition for investment, the ICA database collects a considerable amount of information otherwise dispersed among sources.

Table 9: Incentive Programs vs. Unspecified Incentive deals

Incentive Programs vs Unspecified Incentive deals (Oct 2011 - Oct 2013)

<i>Number of Incentive deals</i>				<i>Incentive Value (US\$M)</i>			
USA	FDI	Domestic	Total	USA	FDI	Domestic	Total
Named program	201	2224	2425	Named program	289.35	5249.53	5538.88
Unspecified program	222	1176	1398	Unspecified program	3487.91	5032.47	8520.38
Federal (National)	2	8	10	Federal (National)	26.40	159.11	185.51
State (Province)	111	543	654	State (Province)	2717.08	2500.25	5217.33
Local (City, County)	109	625	734	Local (City, County)	744.43	2373.11	3117.54
Total	423	3400	3823	Total	3777.26	10282.00	14059.26

Top 5 Sectors (Jan 2010 - Oct 2013)

<i>Number of Deals</i>		<i>Incentive Value (US\$M)</i>		
USA	FDI	FDI	Domestic	Mean
Automotive	289	5431.809		31.39
Basic materials	173	3331		58.43
Industrial Goods	138	2148		195.27
Consumer Goods	96	1785.915		35.7
Life Sciences	89	1408.962		4.88

USA	Domestic	Domestic	Mean
Services	868	1449.34	5.72
Industrial Goods	831	13678.84	68.73
Basic Materials	720	3702.42	11.94
Consumer Goods	692	2155.74	3.11
Food & Drink	597	2117.66	2.44

Top 5 Business Functions

<i>Number of Deals</i>		<i>Incentive Value (US\$M)</i>		
USA	FDI	FDI	Domestic	Mean
Manufacturing	800	11915.75		14.89
HQ	117	2719.30		271.93
RDD	73	582.92		4.98
Business Services	49	476.00		17.00
Construction & Infrastructure	28	244.42		4.99

USA	Domestic	Domestic	Mean
Manufacturing	3182	12956.22	4.07
Business Services	831	10686.91	314.32
HQ	649	4038.17	6.22
RDD	503	1797.02	4.19
Construction & Infrastructure	428	1410.74	1.69

Source: www.ICAINcentives.com by Investment Consulting Associates (ICA) -2013.

⁵⁸ See footnotes 50, 51 and 52 for explanations on this database and Appendix 2.

Number of FDI and domestic deals for “named” vs. “unspecified” deals: FDI incentive deals were far fewer in number than domestic incentive deals in the US. FDI incentive deals accounted for 5% of named program deals, and 40% of unspecified program deals. These unspecified programs for FDI projects are 10 times larger overall in monetary terms than the named programs for FDI, potentially reflecting the costly consequences of allowing incentives to be granted on an ad hoc basis and with significant latitude for discretionary decision-making.

Granting authority. In the US, unspecified incentive deals for domestic firms are more prevalent at the local level than at the state level. However, most expenditure for those unspecified deals still comes from states, suggesting that investment incentive deals are larger at that level.

Incentive values. The total amount identified by ICA as having been spent in the US on investment incentive deals between 2011 and 2013 was US\$ 14 billion, with the incentive deal value being US\$ 3.7 million on average. Yet due to the lack of transparency around incentive deals in many states, this figure likely significantly underrepresents the actual amount given to investors. Indeed, other estimates looking at data for 2005 put the *annual* figure at nearly US\$ 47 billion.⁵⁹

For unspecified programs, the average deal value for FDI incentive deals is almost 4 times larger than the average deal value for domestic deals, whereas for named programs, the average deal value for domestic investment is 1.6 times larger than for their foreign counterparts.

The higher deal value for foreign firms for unspecified programs is also reflected in the wider findings of the ICA’s total database, which indicates that foreign firms who take up an investment incentive program seem to promise more jobs and a higher value of capital expenditure than local firms.

Sectors: Automotive incentive deals account for the largest number of FDI investment incentive deals, while most incentive deals for domestic firms are for investments in services and industrial goods. However, like the UK, the US targets more advanced sectors too, such as renewable and non-renewable energy investments. The US also spends a considerable amount on “Basic Materials”⁶⁰ incentive deals, and primarily with foreign firms. After renewable energy, which dwarfs everything else in monetary terms, Basic Materials accounts for the largest sector of investment incentive expenditure (all types of investments considered).

Business Functions: Manufacturing accounts for 60% of total incentive deals, with Business Services the second most common Business Function. In the US a considerable number of investment incentive deals for both foreign and domestic firms relates to headquarter incentives.

⁵⁹ Thomas, ch. 6, at 14.

⁶⁰ Defined in Appendix 2 as "Chemicals, industrial gases, Agrochemicals, Basic inorganic chemicals, Basic organic chemicals, Paints/coatings/sealants, Petrochemicals, Printing inks, Synthetic dyes/pigments- Natural materials such as wood, stone, ceramic, glass etc."

RDD also features among the top Business Functions being incentivized, with domestic firms receiving a much greater share in the number of deal than FDI projects.

Incentives and the different US states

The number of incentive deals awarded per state as well as the average amounts awarded per incentive deal varies greatly. Illustrating this, California spent roughly 622 times more than Wyoming on incentives during the period from January 2010 to October 2013 (See Appendix 2, Table 16).

Similarly, comparing GDP per capita and amount of incentives given in different states, shows much variation. Poorer states are not necessarily associated with a higher level of incentives in relation to their GDP, nor are the wealthier states associated with a lower level (See Appendix 2, Table 17). This reflects that, in contrast to the EU, there is no regime to restrict the use of incentives by those wealthier states in order to level the playing field within the country.

In terms of number of deals, the most incentives were granted by Kentucky (202), followed by New York (176), Ohio (169) and Indiana (159). Among the group of states that granted more than 30 incentive deals in 2012, Louisiana, which provided 137 incentive deals, gave the highest average awards, with each project receiving roughly US\$ 18.4 million in incentives. It was followed in that group by Pennsylvania, with 120 deals each worth an average of US\$ 15.0 million, and New Jersey, which provided 54 incentives packages at an average value of US\$ 9.7 million per deal.

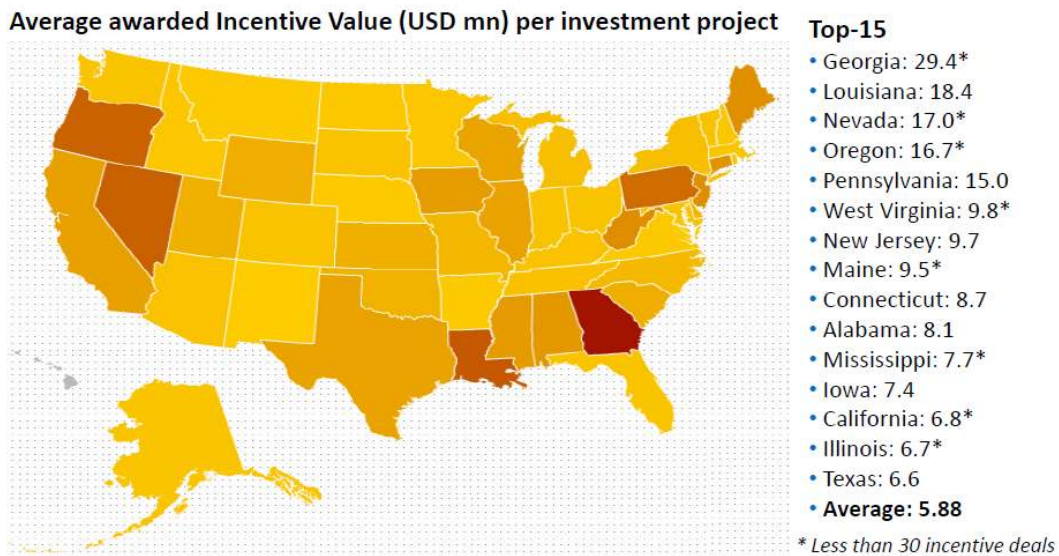
Among states that granted less than 30 incentives deals in 2012, Georgia offered the largest packages, with an average of US\$ 29.4 million granted per investment project. Nevada, Oregon, and West Virginia followed with figures of US\$ 17.0 million, US\$ 16.7 million, and US\$ 9.8 million, respectively.

Figure 6: Number of awarded incentives per US State, 2012



Source: www.ICAincentives.com by Investment Consulting Associates (ICA) -2013

Figure 7: Average awarded incentive value (US\$ million) per investment project, top 15, 2012



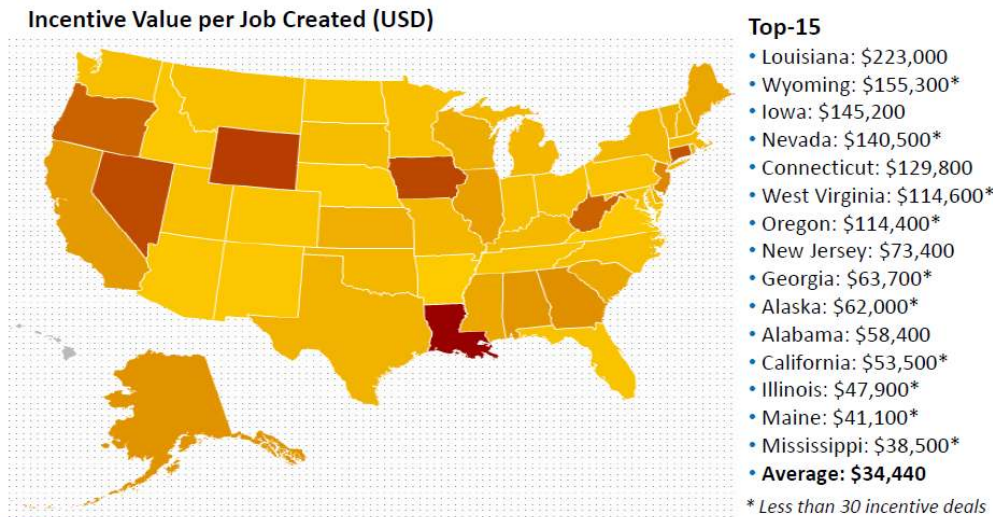
Source: www.ICAincentives.com by Investment Consulting Associates (ICA) -2013.

Incentive intensity and Investment benefits:

Based on the relationship between jobs reported to be created and the amount of incentives granted, it appears that some states are paying high prices for anticipated new jobs. Examining the investment incentives deals identified for 2012 shows that US states provided an average of

US\$34,440 per job, with Louisiana again topping the list by spending almost a quarter of a million dollars for a single new projected job.

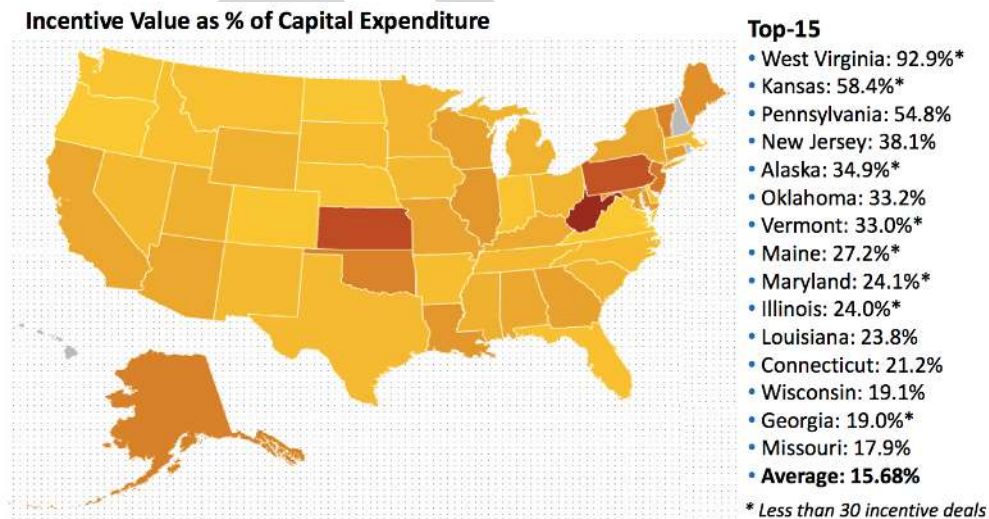
Figure 8: Incentive value per job created (US\$), top 15, 2012



Source: www.ICAincentives.com by Investment Consulting Associates (ICA) -2013.

Similarly, states are also providing incentives with high aid intensities. Looking at the relationship between capital expenditure and the amount of incentives granted, some states like West Virginia, Kansas and Pennsylvania have taken on a large share of the costs of the investment by subsidizing more than 50% and up to 93% of the capital expenditure. On average investments are generally helped at a level of 16% of their capital expenditure.

Figure 9: Incentive value as a percentage of capital expenditure, top 15, 2012



Source: www.ICAincentives.com by Investment Consulting Associates (ICA) -2013.

As Figure 10 shows, there is no correlation between the top 5 spenders measured in terms of incentive value per job created (Louisiana, Wyoming, Iowa, Nevada, Connecticut) and the top 5 states benefiting from job creation (Tennessee, North Carolina, Indiana, Pennsylvania, New York). Similarly, there is little correlation (besides for Pennsylvania) between the top 5 spenders measured in terms of incentive value as a percentage of total capital expenditure (West Virginia, Kansas, Pennsylvania, New Jersey, Alaska) and the top 5 states benefiting from capital expenditure generation (Louisiana, Texas, Indiana, Iowa, Pennsylvania). The states attracting large investments and generating jobs are thus not necessarily the ones granting incentives with the greatest aid intensity, or with the highest amount per job, raising questions about the efficiency of these tools and illustrating the importance of ensuring that incentives, if granted, are not excessive.

Figure 10: Value of generated capital expenditure and newly created jobs, top 15 states, 2012

Top-15 Value of generated Capital Expenditure (USD million)		Top-15 Number of newly created Jobs	
1. Louisiana	\$10,464	1. Tennessee	22,370
2. Texas	\$4,878	2. North Carolina	17,520
3. Indiana	\$4,154	3. Indiana	16,220
4. Iowa	\$3,859	4. Pennsylvania	15,850
5. Pennsylvania	\$3,179	5. New York	15,440
6. Oregon*	\$2,454	6. Texas	15,365
7. Tennessee	\$2,099	7. Ohio	15,350
8. North Carolina	\$2,043	8. Florida	14,090
9. New York	\$2,018	9. Kentucky	12,980
10. Kentucky	\$1,994	10. Louisiana	11,270
11. Ohio	\$1,760	11. Michigan	10,500
12. Georgia*	\$1,688	12. Oklahoma	8,970
13. Florida	\$1,645	13. Wisconsin	7,580
14. Alabama	\$1,633	14. Utah*	6,620
15. Connecticut	\$1,364	15. Colorado	5,850
Total	\$56,730	Total	256,219

Source: www.ICAincentives.com by Investment Consulting Associates (ICA) -2013.

Figure 11: Value of generated capital expenditure and newly created jobs, top 5 deals, 2012

Top-5 Value of generated Capital Expenditure (USD million)					
Company	Destination State	Capital Expenditure (USD million)	Awarded Incentive Value (USD million)	Created jobs	Type
1. Shell Chemicals	Pennsylvania	\$2,500	\$1,650 (Tax Credit)	1,000	Greenfield
2. Sasol	Louisiana	\$2,100	\$2,000 (Tax Credit)	1,253	Greenfield
3. CF Industries	Louisiana	\$2,100	\$5 (Tax Credit)	93	Expansion
4. CF Industries	Iowa	\$1,700	\$71 (Tax Credit)	100	Expansion
5. Dow Chemical	Texas	\$1,700	\$1 (Cash Grant)	150	Expansion

Top-5 Value of Top-5 Value of newly created Jobs					
Company	Destination State	Created jobs	Awarded Incentive Value (USD million)	Capital Expenditure (USD million)	Type
1. Apple	Texas	3,600	\$36.10 (Tax Credit)	\$304	Expansion
2. Warner Bros	North Carolina	3,565	\$6.32 (Tax Credit)	\$25.26	Greenfield
3. Kohl's Corporation	Wisconsin	3,000	\$62.50 (Tax Credit)	\$250	Greenfield
4. CFS II	North Carolina	2,000	\$0.50 (Multiple)	\$6.63	Greenfield
5. Hospital Corporation of America	Tennessee	1,750	\$66.0 (Tax Credit)	\$200	Expansion

Source: www.ICAINcentives.com by Investment Consulting Associates (ICA) -2013

As further discussed in Section 3, the Pew Center on States' research and ICA find that most incentive frameworks today lack clear evaluation and monitoring procedures and if they do, there is often a lack of understanding about the costs and benefits of incentives.

Incentives in Latin America - ICA Investment deals database⁶¹

In Latin America, the ICA database collection efforts again face the challenge of the lack of transparency. The majority of countries in South America do not provide information on their incentive deals or the information is not readily available. These include Bolivia, Chile, Ecuador, Guatemala, Honduras, Peru, Paraguay, Uruguay and Venezuela. Nicaragua, Costa Rica, Panama release some information, mainly on Free Enterprise Zones. Mexico, Argentina and Brazil release the most information, which is presented below in Table 10.

⁶¹ See footnotes 50, 51 and 52 for explanations on this database and Appendix 2.

Table 10: Mexico, Argentina, Brazil, 2010 - 2013

	Mexico	Argentina	Brazil
Total no. deals	66	71	138
Total incentive amount (\$m)	482.27	969.76	7960
Total new jobs	24,103	8,716	50,358
Total capex (\$m)	4,180	3,610	2,061
Avg Deal Value (\$m)	22.2	23.2	713.54
% Capex	15%	25%	116%
Avg New Jobs per Deal	365	122	364
Avg Incentive Value per Job	\$31,344	\$109,456	\$765,086
Most common Industry	Consumer Goods	Automotive	Food & Drink
Most Common Incentive	Tax credit	Loan	Tax Credit

As per ICA methodology, when incentive deals are associated with unknown values (but a specific incentive program), the existence of the incentive is counted but its value is set at 0. We can expect therefore that the figures relating to average incentive values are actually higher than what is shown in Table 10.

With the data available, we can observe that Brazil is offering much higher incentive deals on average than Mexico and Argentina. One reason for Brazil's high average deal value is that it includes a few very large incentive packages each worth roughly US\$ 3 billion. Brazil's incentive intensity and incentive value per job are also disproportionate as compared to Argentina and Mexico.

Mexico is the most frugal among the three countries (measured by all indicators) but achieves the same level of job creation per deal as Brazil and more than Argentina. It might be due to the most common industry attracted, consumer goods, which is more labor intensive than those attracted by Brazil and Argentina, but it might also be the result of the ineffectiveness of the excessive incentives given by Brazil and Argentina.

African FDI incentives

In 2011, the United Nations Industrial Development Organization (UNIDO)⁶² organized 6,359 face-to-face interviews with top-level managers of foreign- and domestic-owned firms in 19 sub-Saharan African countries to assess, among other things, the use of incentives to attract and retain investment firms across agriculture, mining, manufacturing, utilities, construction and other services.

One finding of the research is that use of investment incentives in Africa is pervasive, particularly in the extractive industries (see Box 4).

⁶² UNIDO 2011- Africa Investor Report - Towards Evidence Based Investment Promotion Strategy http://www.unido.org/fileadmin/user_media/Publications/Pub_free/AIS_Report_A4.pdf

Around half of the respondents in the UNIDO survey reported that they received fiscal or financial incentives such as capital grants, tax exemptions and grants for hiring of staff. Overall, tax incentives including corporate income tax holidays (notably in export processing zones (EPZs), and reductions from the standard rate for taxes such as import duties and value added tax (VAT), were the most frequently used instruments across all surveyed countries, though non-fiscal and non-financial incentives were also found to be widespread. In Burundi and Kenya, capital grants seemed to be more frequently used as an investment incentive than tax breaks, and appeared to have a particularly big effect in the (more capital intensive) primary sector. More than 20 per cent of the responding investors in Malawi, Mali, Nigeria and Tanzania received non-fiscal and non-financial incentives in the form of training for employees; and more than 20 per cent of the respondents in Lesotho, Mozambique, Nigeria, Rwanda and Tanzania received targeted investment incentives in the form of infrastructure provision.

Table 11: Investment incentives provision, by type and country (% of respondents who had received the designated incentives)

	Capital grants	Tax exemption	Grants for hiring	Training employees	Infrastructure	Others
Burkina Faso	22.2%	55.6%	0.0%	11.1%	11.1%	22.2%
Burundi	25.9%	22.2%	7.4%	7.4%	11.1%	66.7%
Cameroon	3.6%	19.8%	0.9%	4.5%	5.4%	78.4%
Cape Verde	5.9%	66.7%	0.0%	3.9%	11.8%	19.6%
Ethiopia	7.3%	59.7%	0.8%	0.0%	14.5%	41.9%
Ghana	7.5%	18.0%	2.5%	7.5%	3.1%	71.4%
Kenya	25.9%	18.2%	0.3%	2.9%	3.8%	51.5%
Lesotho	2.7%	48.6%	0.0%	5.4%	35.1%	40.5%
Madagascar	11.5%	42.3%	1.9%	11.5%	11.5%	48.1%
Malawi	39.3%	57.1%	14.3%	42.9%	17.9%	21.4%
Mali	7.0%	39.5%	7.0%	25.6%	16.3%	30.2%
Mozambique	7.2%	64.9%	6.2%	11.3%	23.7%	23.7%
Niger	14.3%	28.6%	0.0%	14.3%	0.0%	42.9%
Nigeria	25.6%	30.8%	19.2%	30.8%	26.9%	56.4%
Rwanda	20.0%	65.7%	2.9%	8.6%	22.9%	11.4%
Senegal	12.9%	30.6%	8.1%	17.7%	12.9%	64.5%
Tanzania	15.8%	77.2%	7.0%	22.8%	35.1%	12.3%
Uganda	7.8%	41.8%	4.1%	7.8%	15.2%	38.9%
Zambia	4.7%	30.2%	2.3%	7.0%	4.7%	67.4%

Source: UNIDO (2011)

Below is a snapshot of three Eastern African countries:

- **In Kenya**, the more pervasive incentives are related to EPZs. These provide companies with a 10-year corporate income tax holiday as well as exemptions from import duties on raw materials, inputs, machinery, stamp duty, and VAT.⁶³
- **In Tanzania's** EPZs and special economic zones (SEZs), companies are exempted for the first 10 years from paying all taxes and levies imposed by local government authorities, and from corporate income tax in total. In addition, companies are granted import duty exemptions on raw materials and capital goods imported for manufacturing goods. Mining companies are given special treatment; they pay zero import duty on fuel, are exempt from capital gains tax, pay a reduced rate of stamp duty, and receive special VAT relief.⁶⁴
- While **Uganda** provides fewer tax incentives than Kenya or Tanzania it still offers a wide range of tax incentives, such as a 10-year entitlement to a tax holiday for persons who export 80% or more of finished consumer and capital goods, capital and depreciation allowances, and customs duty and exemptions. Their policies are more targeted than those of Kenya and Tanzania, however. They offer corporate income tax holidays for certain categories of businesses, such as companies engaged in agro-processing and those exporting finished consumer and capital goods.⁶⁵

These offerings to investors, however, may have only limited effect. According to UNIDO's survey, incentives packages ranked 11th out of 12 factors in terms of its importance to locational decisions. Economic stability, political stability, costs of raw materials, the local market, transparency of business regulations and legal framework, availability of skilled labor, labor costs, quality of life, availability of local suppliers, and bilateral agreements and double taxation treaties were all considerations that carried more weight for investors.⁶⁶

Box 4: Cost of a pervasive use of tax incentives to attract extractive industries in Africa

Why are companies asking for incentives in the extractive sector?

The extractive industry has long argued that it is a particularly risky and capital intensive industry and therefore deserves some special tax treatment. In particular, the extractive industry is characterized by:

1. A long exploration period with no revenue.
2. A development phase as well as a closure phase with capital outlays higher than in other businesses.
3. After the construction of the mine, the capital is captive and not transportable.

⁶³ Justice Network-Africa & ActionAid International, 2012, Tax Competition in East Africa: A race to the bottom?. Available at http://www.actionaid.org/sites/files/actionaid/eac_report.pdf

⁶⁴ Ibid

⁶⁵ Uganda Investment Authority, EAC Secretariat, in VCC (2013)

⁶⁶ UNIDO 2011- Africa Investor Report - Towards Evidence Based Investment Promotion Strategy http://www.unido.org/fileadmin/user_media/Publications/Pub_free/AIS_Report_A4.pdf

4. Equipment generally needs to be imported.
5. Extractive projects span over several decades and are thus exposed to changes in political circumstances.
6. Commodity prices, and therefore revenues, are cyclical.
7. Costs unrelated to production are incurred to enable a social license to operate.

What are the incentives granted?

Generally they are tax incentives. They take the form of:

1. Lower rates than for other companies;
2. Reduced tax base through special allowances⁶⁷; and
3. Exemption from paying certain types of taxes.

One particular regulatory incentive is also often applied by statute or agreement: stabilization of the taxes, sometimes over the life of the contract. Governments may also agree to stabilize a broader set of laws, or even all laws, affecting the project.

Snapshot on selected countries in Africa: what is the estimated revenue loss as a result of tax incentives?

Tanzania: The Bomani Commission estimated that the government lost US\$ 24 million in 2006-7 and US\$ 36 million in 2007-8 as a result of fuel levy exemptions granted to the six largest mining companies.⁶⁸

Malawi: Tax incentives given to mining companies are costing Malawi at least 8 times more than the revenues received, a loss that could cover 60 % of the costs of the Ministry of Health.⁶⁹

Zambia: As a result of excessive tax breaks, in 2004, despite an increase in copper prices as compared to 1992 and with an equivalent level of copper production, the country received US\$8 million in budget revenue from the copper mining industry as compared to US\$200 million in

⁶⁷ An interesting example comes from South Africa's gold mining income tax formula. Mining companies earning taxable income derived from mining for gold are taxed on a formula basis. The tax rate "y" is applied to the taxable income earned by the company from mining for gold, as determined before any excess mining capital recoupments, but after the set off of any assessed losses. The factor "a" (currently 43) represents the flat marginal rate which applies to each rand of taxable income in excess of the factor "b". The factor "b" is commonly known as the "tax tunnel". It is a form of depletion allowance in terms of which taxable income amounting to "b%" (currently 5%) of mining revenue is free of tax. The factor "x" is the ratio, expressed as a percentage, of mining taxable income (before excess mining capital recoupments, and before assessed losses) to the mining income. (In 2012 the marginal tax rate was reduced from 43% to 34%, but only as a one-off adjustment).

⁶⁸ ActionAid- Tax Justice Network - Revenue Losses owing to tax incentives in the mining sector – Policy Brief -2012 <http://www.policyforum-tz.org/sites/default/files/rtbbriefonmining.pdf>.

⁶⁹ Malawi's Mining Opportunity: Increasing Revenues, Improving Legislation- Report for Norwegian Church Aid- Malawi and Catholic Commission for Justice and Peace-Malawi - July 2013

1992.⁷⁰

Compounding the problem of revenue losses is the fact that tax incentives are often granted through special agreements negotiated behind closed doors, without the consent of and engagement with tax authorities. Consequently the IMF in 2008⁷¹ pointed out that “tax incentives in sub-Saharan Africa are now used more widely than in the 1980s, with more than two-thirds of the countries in the region providing tax holidays to attract investment. Such incentives not only shrink the tax base but also complicate tax administration and are a major source of revenue loss and leakage from the taxed economy.”

Source: ActionAid, Policy Forum, Tax Justice – Network Africa, Christian Aid, Open Society, IMF

Investment incentives in Asia

The Asian Development Bank has collected information regarding incentives used in Bangladesh, Bhutan, Cambodia, Hong Kong - China, India, Indonesia, Republic of Korea, Lao, PDR, Malaysia, Maldives, Nepal, Pakistan, Philippines, Singapore, Sri Lanka, Thailand, Viet Nam, People's Republic of China, Taipei - China.⁷² Key themes from that research is collected below:

- There is substantial variation in most incentive related policies, including corporate tax rates and dividend withholding taxes. Further reductions in corporate income tax rates are usually offered unless the country already has an extremely low corporate tax rate, such as in Hong Kong, where the rate is 16.5%.
- All countries seem to utilize the same types of tax instruments, including import duty and VAT exemptions, accelerated depreciation, and investment allowances and credits. They differ more with respect to their targeting (applicability criteria), and the relative emphasis placed on the various instruments.
- Most incentive policies are targeted, but the targets can be quite broad, aiming, for example, at exporters and or at manufacturing as a whole. For some countries, such as India and Sri Lanka, incentives are listed for a number of key sectors. Some countries use incentive instruments in a differentiated manner across sectors. For example Bhutan has considerable variation in its tax holiday policy for over a dozen sectors.

⁷⁰ (2009). *Breaking the Curse: How Transparent Taxation and Fair Taxes Can Turn Africa's Mineral Wealth into Development*. Open Society Institute of South Africa; Third World Network Africa; Tax Justice Network Africa; Action Aid International; Christian Aid

⁷¹ Finance and Development, IMF, September 2008.

⁷² See: <http://aric.adb.org/taxincentives>; see also appendix 3.

- Incentives are often differentiated regionally to assist in developing undeveloped areas. Thailand's incentives are, to a large extent, differentiated by regions as much as by sectors.
- Tax holidays are common and used by all countries looked at in various forms. Most countries offer a tax holiday for investors, with various qualifying criteria, for between 3-8 years. Complete tax holidays are allowed in many export processing zones (EPZs), free trade zones (FTZs), and special economic zones (SEZs), such as in India. Nepal offers a 10-year tax holiday for industries established in certain undeveloped areas.
- Virtually all countries in question have some form of free zone or similar structure, except possibly Nepal, Maldives, and Bhutan. EPZs tend to offer substantial tax holidays and import duty exemptions. Companies are often exempted from customs duties and taxes on both exports and imports. Some free zones are very targeted, such as in Hong Kong, to advanced R&D activities (focusing on providing infrastructure).
- Provision of infrastructure as an investment incentive is fairly common and often packaged with free zones. For example, Bangladesh offers ready-made factory buildings.
- Some incentives are targeted at FDI though this seems to be less common, at least with respect to incentive deals that draw on transparent and preexisting legislation, rather than discretionary deals negotiated bilaterally. Often, policies that favor foreign investors relate to those who establish themselves in SEZs. Some general examples include:
 - In Viet Nam, foreign enterprises that reinvest profits earned within three years or more are entitled to a refund in the amount of profits tax paid on reinvested profits.
 - In Thailand foreign investors are given a 10-year exemption from corporate income tax, which can be extended for another five years if the company set up by the foreign company has paid THB 150 million worth of operating expenses. But the CIT rate is 25% for foreign investors to start; and 10, 15, and 20% for 10 or more years given certain criteria (standard rate is 32%).
 - For the People's Republic of China, a share of profits earned by foreign investors from their invested enterprises may be exempted from tax. Foreign investment engaged in an encouraged industry or project may enjoy exemption or reduction of local income tax.

- Since its independence, the government of Singapore⁷³ has resorted to targeted fiscal incentives to attract FDI in manufacturing and headquarters (HQ) activity. Incentives are both statutory (administered by the tax revenue authority) and discretionary (administered by government statutory boards based on industry segmentation). The terms of the discretionary incentives are based on a negotiated outcome with the designated government statutory board. Typical discretionary incentives for HQ activity would be as follows: lower concessionary tax rates (0%, 5% or 10%) for International HQ and 15% (up to 5 years) on qualifying income for Regional HQ. For manufacturing activity, it would be 0% up to 15 years on qualifying income for pioneer activity, 5% or 10% on qualifying income up to 20 years for development and expansion activity, and an additional 30% or 50% allowance on qualifying capital expenditure against taxable profits.⁷⁴

Box 5: Investment Incentives for Agriculture and Agro-processing in Africa and Asia

A number of incentives are used to attract FDI in agriculture and agro-industry in Africa and Asia. Incentives tend to cover the entire food industry value chain, from traditional agricultural activities, such as growing crops, to other agribusiness undertakings, such as food processing.

While individual countries generally maintain their own eligibility requirements, some regional and global agreements have overarching rules relevant to investment incentives and agriculture. For instance, the WTO's Agreement on Agriculture restricts the use of agricultural export subsidies. The author's survey of nineteen countries in Africa and Asia⁷⁵, which provide investment incentives, highlights the widespread implementation of fiscal incentives to promote investment in agriculture. For example, eighteen out of nineteen countries offer some kind of corporate tax deductions to encourage investment. Seven countries offer a version of a tax holiday and fifteen provide import duty exemptions for raw goods imported to manufacture or export agricultural products⁷⁶. Although financial incentives, such as loans, are less common in the countries reviewed, they are still used to attract investment in both agriculture and agro-industry processing. For example, Zambia provides financial incentives for farm works and farm improvement⁷⁷, while Taiwan offers a special loan

⁷³ Not recorded in the database of the Asian Development Bank.

⁷⁴ Ernst and Young 2012, Inaugural edition, Incentives in ASEAN Region.

[http://www.ey.com/Publication/vwLUAssets/Inaugural_edition__Incentives_in_ASEAN_region_2012/\\$FILE/Inaugural%20edition%20-%20Incentives%20in%20ASEAN%20region%202012.pdf](http://www.ey.com/Publication/vwLUAssets/Inaugural_edition__Incentives_in_ASEAN_region_2012/$FILE/Inaugural%20edition%20-%20Incentives%20in%20ASEAN%20region%202012.pdf)

⁷⁵ Asian countries include: Cambodia, Indonesia, Laos PDR, Malaysia, Myanmar, Philippines, Taiwan, Thailand, and Vietnam. African countries include: Angola, Burundi, Cameroon, Ghana, Liberia, Morocco, Mozambique, Sierra Leone, Tanzania, and Zambia.

⁷⁶ On file with the author.

⁷⁷ Zambia Agriculture Sector Profile, *Agriculture, Livestock and Fisheries* (2011) p. 20.

program for investments in agriculture technology parks with the goal of expanding the nation's agro-industry.⁷⁸

While fiscal, financial, and business and technical services play an important role, land-related incentives, especially regarding tenure, are an additional and vital type of incentive for the agricultural sector. Land tenure rules can affect how foreign investors view the attractiveness of a country in respect of agricultural investments. Here, too, government policies vary: for example, while Thailand allows foreign ownership of land⁷⁹, many other countries prohibit this, providing instead for long-term leases by foreigners. Myanmar's newly enacted Foreign Investment Law caps long-term leases at 50 years (with possible extensions)⁸⁰, while Tanzania allows foreigners to engage in large-scale, long-term leases for up to 99 years.⁸¹ Furthermore, because foreigners are not permitted to own land in Tanzania, the Tanzania Investment Centre established a land bank, containing over one million hectares of land to lease for foreign agricultural investment.⁸² Such rules governing rights to use land, coupled with more traditional investment incentives, may factor into how investors view agricultural sector opportunities.

Tax incentives around the world⁸³

Tax incentives in one form or the other are used by nearly all countries in the world. Table 12 below shows the prevalence of the different tax incentives among the 136 countries surveyed. Tax holidays are most prevalent in South Asia, Eastern Europe and Central Asia and the East Asia Pacific countries while they are least prevalent in the OECD countries. This reflects the gradual move away from the use of tax holidays over time in the developed countries due to their ineffectiveness in aligning the incentives of increased investment with the tax benefits. There is now a much greater use of tax incentives for encouraging Research and Development with the OECD countries and the East Asia and Pacific countries using this tax incentive most often. Super-deductions, where deductions are allowed for more than the actual cost of certain expenses is most prevalent in South Asia mainly to reduce subsidize the cost of investments when starting a business. The use of tax and duty exemptions in Special Economic Zones (SEZs) is quite popular across all the regions. This may reflect a move towards containing the tax incentives to certain geographic locations and minimize their impact of the tax incentives on the wider economy for revenue reasons. It may also

⁷⁸ Invest in Taiwan, *Preferential Loan for Investment in Agricultural Technology Park*, <http://investtaiwan.nat.gov.tw/eng/show.jsp?ID=46&MID=2> (last visited Nov. 5, 2013).

⁷⁹ Investment Promotion Act, B.E. 2520, § 27, Jan. 2002, available at http://www.boi.go.th/english/download/boi_forms/proact_eng.pdf.

⁸⁰ The Foreign Investment Law, The Pyidaungsu Hluttaw Law No. 21/2012, ch. XIV, §§ 31-33 (Nov. 2, 2012).

⁸¹ Tanzania Investment Centre, *Tanzania Investment Guide 2008 and Beyond*, p. 11.

⁸² See The Land Act, Cap. 113 (R.E. 2002); Tanzania Investment Centre, *Land and Property*, <http://www.tic.co.tz/menu/274> (last visited Nov. 5, 2013).

⁸³ Adapted from James, S. 2013, *Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications*. World Bank Investment Climate Advisory Services. September 2013.

reflect a reaction to the limitations imposed by the WTO that prohibits tax incentives for exporters: indeed in this case, tax incentives provided in SEZs, while not explicitly limiting the tax incentives to exporters, may still be beneficial to exporters because in most cases those SEZs are defined as being outside the customs territory of the country.

Table 12: Prevalence of Tax Incentives around the World

	Number of Countries Surveyed	Tax holiday/ Tax exemption	Reduced Tax rate	Investment allowance/ Tax credit	Duty/VAT exemption / reduction	R&D Tax Incentive	Super-deductions	SEZ/Free Zones/EPZ/Freeport	Discretionary process to avail tax incentive available
East Asia and Pacific	11	91%	91%	82%	109%	82%	9%	100%	36%
Eastern Europe and Central Asia	16	94%	38%	25%	100%	38%	0%	94%	38%
Latin America and the Caribbean	24	79%	29%	46%	67%	13%	4%	79%	29%
Middle East and North Africa	15	80%	47%	13%	67%	13%	7%	80%	27%
OECD	33	21%	30%	61%	79%	76%	18%	67%	27%
South Asia	7	100%	43%	71%	100%	29%	57%	71%	14%
Sub-Saharan Africa	30	70%	67%	77%	77%	13%	33%	63%	47%

Source: Various tax guides

Most notable is the use of discretionary procedures to provide tax incentives across all the regions. In such a system taxpayers “apply” for tax incentives to agencies outside the tax administration. The tax incentive that the taxpayer may qualify for may be specified in the tax law or investment code but it is generally given broad interpretation that requires an approval process. The “automatic” process on the other hand is when tax incentives are provided for in the tax legislation and there is no procedure to “apply” for them. Taxpayers in this case directly claim for their tax incentives during tax filing or during importation. Discretionary tax incentives are prone to corrupt practice, as the “approval” is sought for and valuable for investors. Sub-Saharan Africa uses discretionary procedures more than the other regions of the world. Interestingly, discretionary processes are not uncommon in the OECD countries.

DRAFT

Section 3: Designing incentives programs to get value for money and achieve intended goals

Cost-benefit analyses

As Sections 1 and 2 indicated, countries (and the jurisdictions within them) provide incentives through a range of tools to a wide set of investors, both domestic and foreign. To understand whether the use of these incentives is a good policy strategy, it is necessary to assess their costs and benefits. Yet there are a number of challenges inherent in doing that calculation, among which are that the costs and benefits may be felt by different stakeholders, can vary over time, and can depend on a range of factors such as the incentive tool being used.

Some incentive tools tend to draw more criticism than others. Holidays from corporate income tax, in particular, are among the most frequently criticized tools. However, because they can be relatively easy to administer and do not require any government expenditure, they are often used by developing countries. Those advantages may be outweighed by any one of a number of drawbacks, including that:

- when granted, it may be very difficult for governments to assess the amount of tax revenue they will forgo as a result of the tax holiday;
- income tax holidays are not tied to and do not encourage actions that may be beneficial to the host jurisdiction such as reinvestment of earnings;
- income tax holidays do not enable governments to share in the benefits of highly profitable investments. As the profitability of the investment project increases, the size of the gap between the investors' profits and the government tax revenue will increase; once the incentive is removed, the firm may shut down and relocate to take advantage of another low-tax jurisdiction;
- because income tax holidays tend to be attractive to high-profit investments, there may be a greater likelihood that the investment would have been made anyway even without the incentive;
- income tax holidays can produce greater opportunities for transfer pricing through which firms can artificially shift the profit-generating aspects of their businesses to low-income tax jurisdictions; and⁸⁴
- income tax holidays can result in a transfer of tax revenue from the host country granting a tax holiday to an investor's home country, which taxes the net profit and thus receives greater revenues as a result of the host country exemption.

⁸⁴ See, e.g., Sebastian James, *Providing Incentives for Investment: Advice for Policymakers in Developing Countries*, 7 *Investment Climate in Practice: Investment Policy and Promotion*, No. 7, Jan. 2010.

Other types of fiscal incentives, while responsive to better tailoring, can still result in countries foregoing significant amount of revenues. In Rwanda and Sierra Leone, for instance, “more than one-third of tax revenues were given up as incentives— revenues that were badly needed to deliver basic public goods such as health care and education, prolonging both countries’ dependence on aid.”⁸⁵ Tax Justice Network-Africa & ActionAid International (2012:iv), looking at tax incentives only, find that: “In total, Kenya, Uganda, Tanzania and Rwanda are losing up to US\$2.8 billion a year from all tax incentives and exemptions. Not all of these mechanisms are bad. Some, such as VAT reductions, can help reduce poverty. But much of the revenue loss is explained by tax incentives provided unnecessarily to attract foreign investment.”

These losses illustrate that forgone revenue can translate into costly missed opportunities. To try to avoid the losses from these or other types of incentives, governments considering their use can take steps to identify and weigh the factors necessary to assess costs and benefits, and then decide which strategy to adopt. While no easy task and not often done (as described in Box 6 below in the case of the US), there are several techniques available for gauging and analyzing the variables that are presented in this section.

Box 6: Deficient effort of Cost-Benefit Analysis in the US

The Pew Center on the States’ research facilitates an examination of the U.S. states’ practices in evaluating their incentive programs.

In one study,⁸⁶ the Pew Center reviewed 16 hefty tax incentive bills passed between 2007 and 2011 and researched whether (1) reliable cost estimates and (2) annual spending limits were used. The research found that:

- In only four cases, both tools were used.
- Five of the bills were enacted with neither of these fiscal safeguards.
- In seven cases, the legislation lacked one or the other.

In another study,⁸⁷ the Pew Center examined whether policy makers were getting the information necessary to understand if tax incentives are delivering the expected return on investments. To that end, it reviewed roughly 600 documents from state agencies and legislative committees and interviewed 175 policy makers, agency officials and experts. It

⁸⁵ James, S. 2013, *Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications*. World Bank Investment Climate Advisory Services. September 2013.

⁸⁶ The Pew Center on the States, December 2012, *Avoiding Blank Checks, Creating Fiscally Sound State Tax Incentives*, <http://www.pewstates.org/research/reports/avoiding-blank-checks-85899433960>

⁸⁷ The Pew Center on the States, *Evidence Counts*, April 2012
http://www.pewstates.org/uploadedFiles/PCS_Assets/2012/015_12_RI%20Tax%20Incentives%20Report_EXEC_SUMM_web.pdf

found:

- Only four states – Arizona, Iowa, Oregon, and Washington – integrated evaluation of their major incentives into a policy process ensuring that incentive deals were regularly reviewed (between 5 and 10 years).
- Twelve states reviewed all major tax incentives but failed to use the data to inform policy choices.⁸⁸
- 35 did not review all the major tax incentives or use data to inform policy choices.

The Pew Center also highlighted four leading examples that could provide lessons learned for other states:

- under a new Oregon Law, tax credits expire every 6 years but can be renewed. There is no spending cap on expiring incentives, which leads policy makers to conduct evaluations to justify which incentives continue and why.
- in 2007, Washington began a 10-year review process for every tax incentive offered. This process is advised by a working group comprised of nonpartisan analysis working with a citizen commission.
- in assessing the job creation associated with incentive deals, Louisiana realized that some newly created jobs displaced existing positions as a result of distorted competition between the businesses that received incentives and those that did not.
- in 2010, Connecticut's economic development agency assessed the state's major tax credits and concluded that some were not meeting the intended outcomes, but others were beneficial and cost-effective. The review resulted in some of the incentives being eliminated.

Reinforcing these findings, ICA notes that most current incentive frameworks in the US (and elsewhere) lack clear evaluation and monitoring procedures and that there is often a lack of understanding about the costs and benefits of incentives. In particular, many incentive frameworks are not able to measure the benefits derived from the investment vis-à-vis the costs of the incentive package. Apart from assessing and measuring the investment incentive regimes, providing the results and information in publications to third parties enhances the transparency, credibility and public accountability.

This lack of clear evaluation processes is a missed opportunity for all parties because, as ICA has observed, many companies would prefer a transparent and stable incentive program with clear eligibility and monitoring and evaluation mechanisms over an incentive program that is focused on short-term gains.

⁸⁸ Arkansas, California, Connecticut, Delaware, Kansas, Missouri, Nebraska, North Carolina, Ohio, Pennsylvania, Texas, Virginia.

*Gauging the costs and benefits of investment tax incentive policies*⁸⁹

Fiscal incentives have both direct and indirect costs. The direct costs of a fiscal incentive are the revenue losses experienced as a result of giving the tax benefits to an investor that would have invested anyway.⁹⁰ The indirect costs, which can also be substantial but are more difficult to measure, include:

- Distortions created by encouraging new investments that are detrimental to existing ones.
- Time and money spent by businesses lobbying the government for tax incentives.
- Time and money spent by businesses qualifying for and obtaining tax incentives.
- Revenue lost to illegal activity, such as when businesses that do not qualify for tax exemptions falsify information to do so, or indirect revenue lost to businesses that do not qualify for tax incentives but illegally use tax-exempt entities to source goods.
- Additional costs for authorities responsible for administering tax incentives.⁹¹

Benefits also can be direct and indirect. One benefit that is relatively easy to measure is job creation by those investors that changed their decision to invest as a result of the tax incentive. Other spillover benefits can also accrue, such as:

- Investments in technology—such as research and development or high-tech industries—that upgrade worker skills.
- Infrastructure projects that encourage business growth.
- Investments that create jobs in areas with high unemployment.
- Environmentally-friendly technology.
- Anchor investments—that is, those that provide multiplier effects through signaling and by creating backward linkages into the local economy.⁹²

These positive externalities are often challenging to calculate, but can be important for assessing the desirability of an incentive.

Figure 12 illustrates a cost-benefit analysis examining these issues. Note, however, that it focuses only on economic costs and benefits, and does not take into account other social and environmental

⁸⁹ Section adapted from James, S., *Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications*. World Bank Investment Climate Advisory Services (September 2013).

⁹⁰ There are three methods used for calculating tax expenditures: (1) the revenue foregone method; (2) the revenue gain method; and (3) the outlay equivalent method. James, 2013, at 20-21.

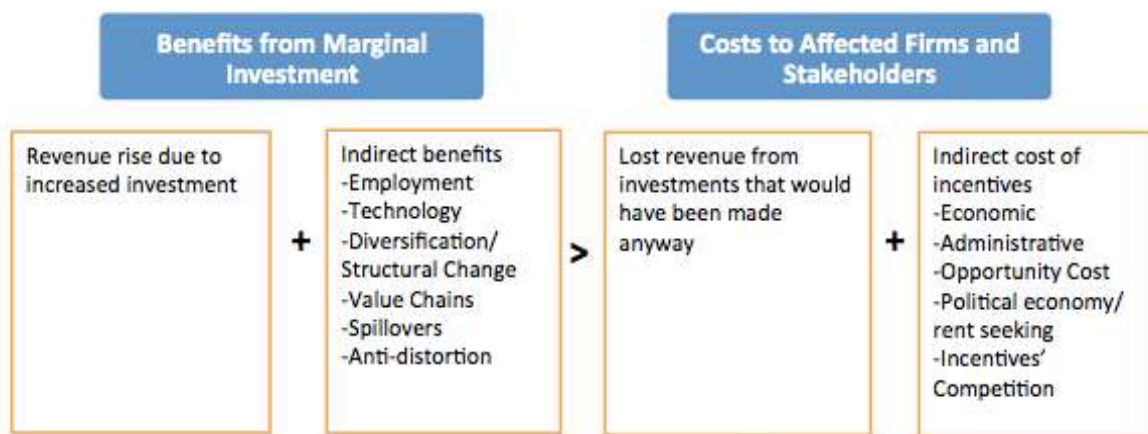
⁹¹ James, S., *Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications*. World Bank Investment Climate Advisory Services (September 2013).

⁹² James, S., *Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications*. World Bank Investment Climate Advisory Services (September 2013).

considerations. The “Marginal Investment” is the investment that would *not* have been made if the tax incentives were not provided.

For tax incentives, an investment incentive is beneficial if the equation shown in Figure 12 is positive.

Figure 12: The basic equation of the cost-benefit analysis



Source: Sebastian James, World Bank Group, December 2009, "Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications"

One of the limitations of this cost-benefit model is that it focuses on economic costs and benefits. Incentive policies are not always considered from an economic standpoint, but rather may be dictated by other political and/or social considerations.

A first metric for measuring the cost-effectiveness of tax investment incentive policies would be to limit the benefits to the jobs created by the "Marginal investors"⁹³ and the cost would be the revenue cost for the investments that would be made anyway. A useful metric in this case is the revenue cost for each job created. Though this does not entirely cover all the costs as well as all the benefits, it provides a ballpark figure that can help policymakers decide if the incentive was worthwhile.

For example, a 2008 Investment climate advisory study found that the Yemeni government spent about US\$6,000 each year for each of 8,000 jobs that investment incentives helped create—more than six times the country’s per capita income. In Thailand a 1999 FIAS study found that investment incentives per job created was 16 times the average annual wage of an industrial worker. In the case of Tunisia it was found that the cost of tax incentives for each job created was three and a half times the per-capita income.

Table 13 gives a first approximation of the cost versus the benefits based on a survey that the World Bank⁹⁴ carried out.

⁹³ The "Marginal Investor" is the investor who identified themselves (in the World Bank Investment Climate Advisory Services’ survey) as one who would NOT have made the investment if the tax incentives they are benefiting from currently were not provided.

⁹⁴ James, S. 2013, *Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications*. World Bank Investment Climate Advisory Services. September 2013.

Column (1) gives the redundancy ratio, which is the percentage of investors who would have invested even without the tax incentives. Column (2) shows the percentage of jobs created by these "Marginal investors". Column (3) shows the cost-benefit analysis: if the "Marginal investors"⁹⁵ on average create more jobs as a percentage of the total jobs as compared to their proportion of investors then one could argue that the "Marginal investors" provide more benefits than the typical investor. If the number is negative it means that there is less job creation associated with "Marginal investors" than with others, so "Marginal investors" are not that beneficial for the country.

Table 13: Marginal Investors and Job Creation

Country Surveyed	Redundancy ratio (Answered Yes to the question –“Would you have invested in the country even if tax incentives were not provided?”) (1)	Jobs Created by Marginal Investors as a % of total jobs created (2)	(%) Jobs by Marginal Investors – (%) of Marginal Investors (2) – [100% - (1)]
Burundi	77%	19%	-4%
Guinea	92%	13%	5%
Jordan	70%	21%	-9%
Kenya	61%	42%	3%
Mozambique ⁹⁶	78%	15%	-7%
Rwanda	98%	1%	-1%
Serbia	71%	31%	2%
Tanzania	91%	16%	7%
Thailand ⁹⁷	81%	-	-
Tunisia	58%	35%	-7%
Uganda	93%	7%	0%

⁹⁵ See footnote 93 for definition

⁹⁶ Bruce Bolnick (2009). “Investing in Mozambique – The role of Fiscal Incentives,” Report by Nathan Associates for USAID.

⁹⁷ “Kingdom of Thailand - A Review of Investment Incentives,” Foreign Investment Advisory Services (FIAS) 1999.

Vietnam ⁹⁸	85%	-	-
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There following are metrics that provide policy makers with different ways of estimating the costs and the benefits:

1. Percentage of Jobs created by Marginal investors [Benefits]
Versus
Percentage of Marginal investors as compared to the total investors [Costs]
(Explanation: As shown in Table 13 above)
2. Jobs created by all the investors benefiting from tax incentives [Benefits]
Versus
The total tax expenditures [Costs]
(Explanation: When we do not have the exact amount of tax incentives claimed by the investors as well as the jobs created by the marginal investors)
3. Jobs created by Marginal investors [Benefits]
Versus
The Revenue cost as measured by the percentage of non-marginal investors multiplied by the total tax expenditures [Costs]
(Explanation: When we do not have the exact amount of tax incentives claimed by the investors but we are able to find though surveys the marginal investors as well the jobs they create)
4. Jobs created by Marginal investors [Benefits]
Versus
The Revenue cost as measured by the actual tax expenditures incurred by the non-marginal investors [Costs]
(Explanation: When we do have the exact amount of tax incentives claimed by the investors as well as the jobs created by the marginal investors)

The cost and benefits as described above give policy makers rough estimates that could then be used to devise policy. Benefits such as diversification and skill development are much more difficult to measure. However it is possible to provide similar estimated cost-benefit analyses as follows:

- Creating not just more jobs but higher-value added jobs
Multiply the jobs created by the marginal investors in different categories with the salary paid to the staff in each of these categories where the salary is the proxy of the value-added.

⁹⁸ Nguyen Thi Canh et. al. (2004), “An Empirical Study of Corporate Income Tax Investment Incentives for Domestic Companies in Vietnam”. USAID Report for the Vietnam Competitiveness initiative.

- Creating not just direct jobs but also indirect jobs in all the industries that are incentivized beyond the marginal investors
Multiply the jobs created by the marginal investors by a factor that captures the indirect jobs created, which could vary by sector.
- Creating new skills and research jobs
Estimate the jobs created under different categories including research jobs and use the same metric of the cost to create these jobs. Alternatively, estimate the revenue costs for each of the patents that the tax incentives have incentivized.

Moving beyond the jobs versus revenue cost analysis, governments could consider a broader range of factors relevant to costs and benefits when assessing whether to offer incentives and, if so, what amount. Figure X illustrates a range of quantifiable and unquantifiable items to consider when identifying benefits and costs.

Figure 13: Framework to assess benefits

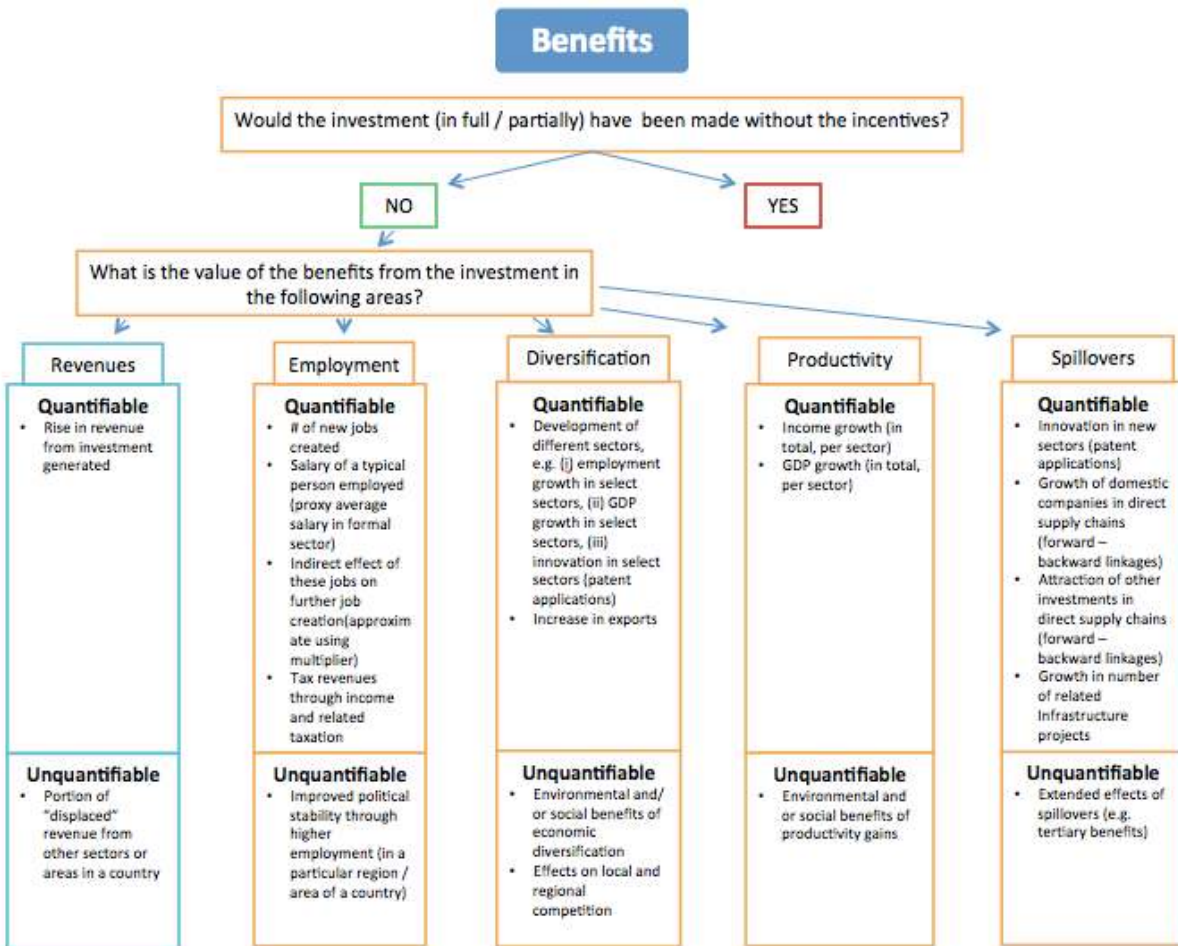
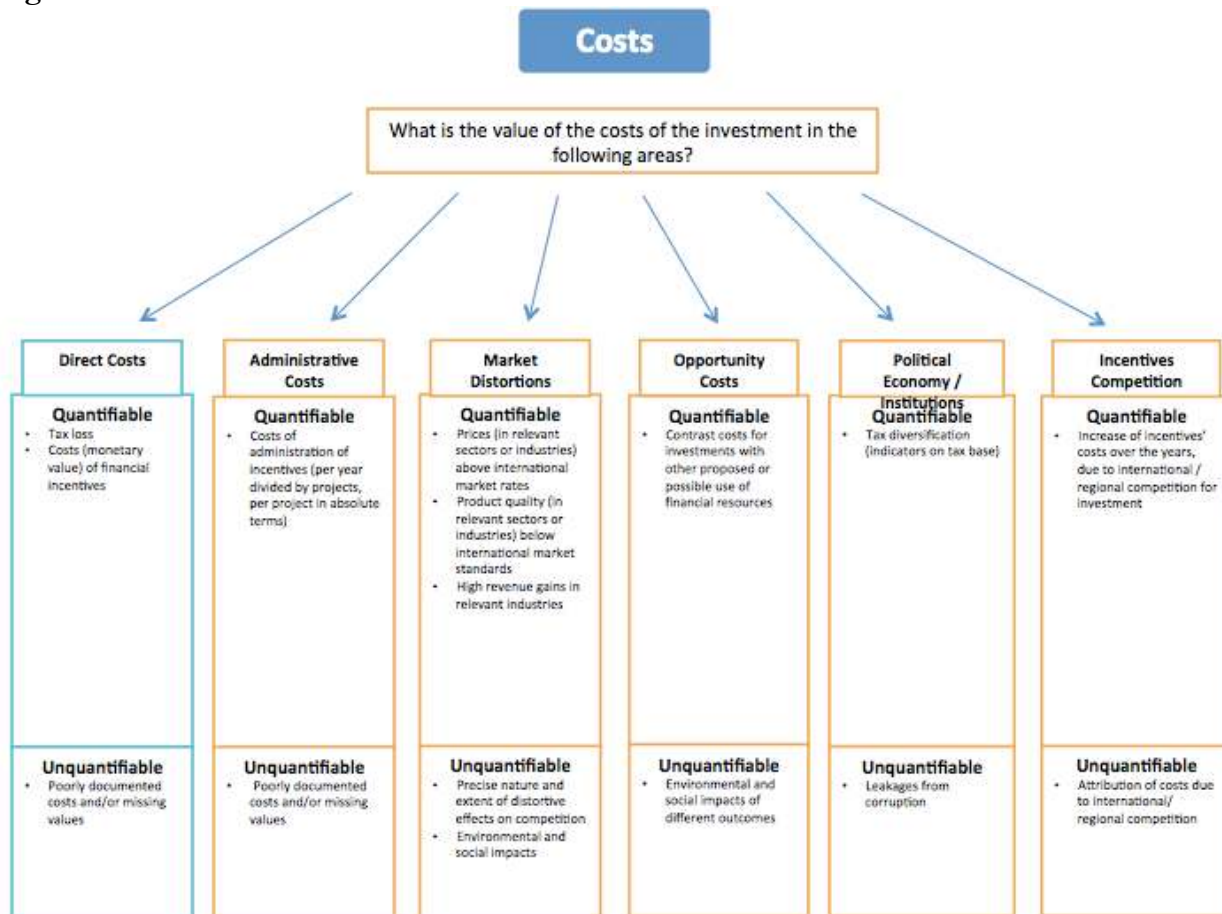


Figure 14 similarly illustrates potentially relevant costs.

Figure 14: Framework to assess costs



The World Bank notes that this methodology is particularly challenging for financial incentives. Financial (non-tax) incentives, compared to tax incentives, can be more difficult to measure for a number of reasons, including:

(i) The diversity of the type and form of financial incentives

The types of non-tax incentives are varied, and often have different policy objectives, implementing bodies, and sources. Even by limiting the discussion of non-tax incentives to those that are quantifiable and specific, such incentives can take a variety of forms, from direct grants to reduced prices on real estate.

A country may provide a very large number of these incentives across different sectors, and different bodies can administer them. Therefore, the disparate nature of financial incentives can render their cost calculations more complex. Moreover, their policy objectives, particularly for behavioral incentives (incentives meant to induce certain behavior, such as R&D incentives and training incentives), can make it hard to assign a numerical value to calculate their benefits beyond investment generation.

(ii) Their proclivity to corruption and other issues related to political economy

Since most financial incentives are very targeted and may be offered in a discretionary form, they are more apt to political abuse. As such, the challenges of collecting accurate data and accounting for rent-seeking and other implications related to political economy become more pronounced. Additionally, the political motivations for using financial incentives can be more likely to override the economic rationale behind them.⁹⁹

Assessing costs and benefits outside the granting authority's jurisdiction

In addition to the costs for the granting jurisdiction, incentives can also have external impacts, both positive and negative. Incentives might indirectly impose costs on other jurisdictions by leading them into a “race to the bottom” in terms of their incentives policies, or by causing them to lose taxation revenue due to transfer pricing practices. Yet they can also provide benefits by encouraging outward investment in areas or activities in which that investment might not otherwise be made, and generating positive spillovers in the home, host and even third countries.

Some processes and guidelines do exist for assessing effects of incentives on areas external to the granting jurisdiction. As described further in section 4, EU rules regarding State aid consider the effects of one member state's grant of incentives on other states within the EU. Another relevant example can be found in the practice of the US Overseas Private Investment Corporation (OPIC), which assesses the effects – both at home and abroad – of the investments it supports. OPIC is a U.S. government entity established by law to encourage socially and environmentally sustainable investment into developing countries where, without such support, the investment would likely not have occurred. Before receiving OPIC support and annually thereafter, projects must report on key criteria demonstrating the extent to which they will or do have positive impacts in their host countries and also helping establish that they do not and will not have impermissibly negative impacts in the US or result in net U.S. job loss.¹⁰⁰

In order to assess impacts on the host country, investment projects seeking OPIC support must complete questionnaires that ask for details on such factors as whether the project:

⁹⁹ James, S., *Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications*. World Bank Investment Climate Advisory Services (September 2013).

¹⁰⁰ See OPIC Self-Monitoring Questionnaire for Finance, Insurance, Reinsurance, and Investment Funds Projects, Form OPIC-162, Expiration Date 5/31/2015, available at: <http://www.opic.gov/sites/default/files/files/OPIC-162-FY2012-SMQ-FOR-PUBLIC%20USE.pdf> (last visited Nov. 3, 2013); OPIC Office of Investment Policy Questionnaire, Form OPIC-248, available at <http://www.opic.gov/sites/default/files/files/OPIC-248-OIP-Questionnaire.pdf> (Nov. 3, 2013).

- will be located in any environmentally sensitive area or areas of national or regional importance;
- relates to activities or goods that are subject to domestic or international regulation and may be banned, phased out or restricted due to their negative impacts on health or the environment;
- will hire men and/or women, skilled and/or unskilled labor, domestic and/or foreign workers, and temporary and/or permanent employees;
- will provide workers with training and, if so, what percentage of workers they will train and what types of training they will provide;
- will provide “ancillary” benefits or services not directly related to business activities such as charitable donations or activities, scholarship programs, recreational facilities, schools, or medical clinics;
- will have human resources staff and policies, offer benefits such as healthcare, and go beyond what is legally required under domestic law in terms of those benefits;
- will result in restructuring causing the dismissal of workers in the host country;
- will transfer technology to the host country in the form of new or uncommon management practices, marketing and/or distribution techniques, production and/or processing techniques, or goods or services;
- will provide technical assistance or training to customers, industry counterparts, or suppliers;
- will provide training on international industry standards and certifications; and
- will reinvest earnings into the host country.

To evaluate the impacts on the home country, the OPIC questionnaires ask for annual reports on such information as:

- whether the project has a monopoly position in the home country (or any other market);
- whether the project will, at its initial stages as well over the life of its operations, procure goods or services from U.S. suppliers and, if so, in what amounts and from what types of suppliers (e.g., whether the enterprise is minority- or female-owned, whether it is a small enterprise, and where the enterprise is located);
- whether the project results in job loss in the US; and
- where remittances will be sent, including what portion will be remitted to the US.

The information disclosed through these questionnaires assists OPIC in its efforts to ensure that the outward investment incentives it provides serve its development-related aims abroad, and that such efforts do not have unknown or undue negative impacts on jobs or other interests at home.

Policies for minimizing costs and optimizing benefits of tax incentives¹⁰¹

A good tax system ensures predictable revenue for government, is stable, and minimizes distortions in investment decisions. There is broad consensus that applying tax instruments with reasonable tax rates over a broad base is sound policy. Paradoxically, that approach rules out all tax incentives.

However, some experts have argued that governments should have less neutral policies because not all investments are the same and some incentives may be needed.¹⁰² Silvani and Baer (1997) note that in many developing countries a tax system with few taxes, a limited number of rates for each tax, limited exemptions, and a broad base has proven much easier to administer and resulted in higher compliance than a complex tax system. Wallschutzky (1989) suggests that an ideal tax system should keep tax laws as simple as possible, aim for a global tax with few exemptions, credits, rebates, or deductions, not try to achieve too many social and economic goals, and be continually monitored.

Having few exemptions limits the need to verify case-by-case compliance with the conditions under which exemptions are granted. Tax administration costs and complexity increase if the tax system is used to achieve nonrevenue goals. In addition to creating a narrower base, reducing equity, and imposing price distortions, differential treatment greatly increases information requirements for the tax administration, provides opportunities for misreporting, and complicates tax compliance requirements. Tax concessions for nonrevenue objectives should be used very selectively and only after comparing their effectiveness with alternative expenditure, subsidy, or regulatory instruments that can potentially achieve the same goals.

The indirect savings due to reduced opportunities for noncompliance can justify broad tax bases.¹⁰³ Allowing few exclusions from the tax base reduces the scope for tax evasion whereby the tax evader incorrectly claims tax exemptions. Furthermore, for a given revenue requirement, tax rates can usually be lower than with a narrow base.

That being said, political economy considerations and short-term constraints may force countries to offer some kind of tax and non-tax incentives. Table 14 summarizes desirable short- and long-term incentive policies for countries facing a variety of conditions.

Table 14: Incentive Policies under Various Country Scenarios

Country Scenario	Short term policy	Long term policy
Countries with very weak investment climate	Investment incentives are ineffective and therefore lead to waste of tax revenues. Tax revenues instead should be used to create	Country should work to reduce barriers to investment and focus on simplifying investment

¹⁰¹ Adapted from James, S. 2013, *Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications*. World Bank Investment Climate Advisory Services. September 2013.

¹⁰²Ibid footnote 11. Page 85-86.

¹⁰³FIAS. 2009. *Handbook of Tax Simplification*,(ed. Sebastian S. James). Chapter 5.World Bank Group.

	public goods. Reforms should also be introduced to rationalize the tax system, the tax instruments, and the rates as well the tax administration.	process widely.
Countries facing tax competition	Incentives may be used to ensure that the country is not at a disadvantage to its neighbors. ¹⁰⁴	Such countries should work on regional pacts to stop harmful tax competition. Countries should also work on marketing the more substantive differentiations eg. labor, skills, infrastructure, etc or develop a unique selling proposition.
Countries planning to diversify their economy	Countries may use incentives that are linked to investment growth (investment allowance, accelerated depreciation, etc.) but only for a limited period based on clear prioritization of sectors in line with FDI competitiveness	Broader industrial policy strategies have to be followed, including a focus on sector targeting and promotion for investment
Countries possessing unique advantages (natural beauty, natural resources)	General investment incentives to attract investments that exploit such advantages waste revenue, unless they kick start investment	Barriers should be lowered for investments designed to exploit the natural resource, access to land, good quality infrastructure, and so on.

In particular tax holidays – although a popular incentive – should be avoided as they have numerous disadvantages:

- Tax holidays are a blanket benefit unrelated to the amount of capital invested or its growth during the holiday. An alternative is to set minimum capital investment growth requirements to receive a tax holiday.
- Firms have an incentive to close and sell their businesses at the end of the tax holiday—only to reopen as a “new” investment, thus gaining an indefinite tax holiday.
- If FDI operates under double taxation agreements, tax holidays simply transfer tax revenues from the country receiving the investments to the investing home country.

¹⁰⁴ While such a strategy was effective in the case of Antigua, it is possible that it took investment away from its neighbors through tax competition. As a result, while Antigua gained, it is likely that this was at the cost of its neighbors. Further in the long term, it erodes the tax base creating the need to tax other sources such as labor and consumption.

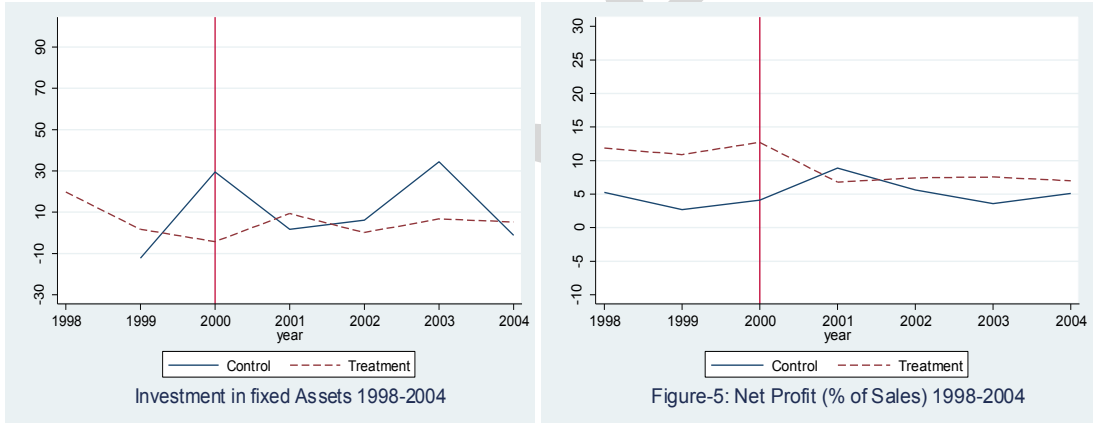
- Tax holidays enable firms to funnel profits, using transfer pricing (see Box 7), from an existing profitable company through the “tax holiday” company and so avoid paying taxes on either.
- Most capital-intensive investments do not yield a profit until several years after operations start. Thus tax holidays for a “start up” period of five years are ineffective. Indeed, tax liabilities often kick in just about when a business starts to make a profit.

Box 7: Incentives and Investment in India: The Role of Institutions and Issue of Transfer Pricing

In 2000 the Indian government removed incentives to exporters except those located in export processing zones or qualified as export-oriented units. Investment behavior quickly changed among firms that lost their incentives. To study these changes, firms from the zones and export-oriented units—which were quite similar—served as a control group. To make them comparable to other firms, only garment exporters from one Indian state (Tamil Nadu) were studied.

The figure on the left below shows how investments changed after 2000. Firms that lost their incentives maintained the same amount of investment despite higher tax rates. A similar trend occurred with the control group, indicating that investments were unaffected by the removal of incentives.

Investor Responses to Removal of Incentives in India, 1998–2004



That said, an interesting side story has implications for incentive policy. The right figure above shows how reported profits responded to the loss of incentives. Reported pre-tax profits dropped by half in the group that lost incentives despite almost no change in business parameters such as sales or export composition. But pre-tax profits did not fall because incentives disappeared: only the amount reported fell, as confirmed by tax audits. This implies that investors reacted to the loss of incentives by evading more taxes. In addition, it was found that among investors who owned two industrial units with one unit in the zone and the other outside, the pre-tax profits of units in the zone were far higher than those outside even when both units were manufacturing the same product

in the same city. Thus, it was discovered that when companies had two units, one of which benefited from tax incentives while the other did not, the profits of the unit that did not benefit were often much lower than the profits of the unit that did, indicating a diversion of profits to the tax-exempt entity

Source: James 2007¹⁰⁵ and 2013

As noted, tax holidays often motivate firms to reorganize in order to extend their benefits. Another potential problem for tax authorities arises when existing investors not receiving tax holidays reorganize to receive benefits. This runs counter to the intended goal of encouraging new investment, with the added risk of shrinking the tax base.

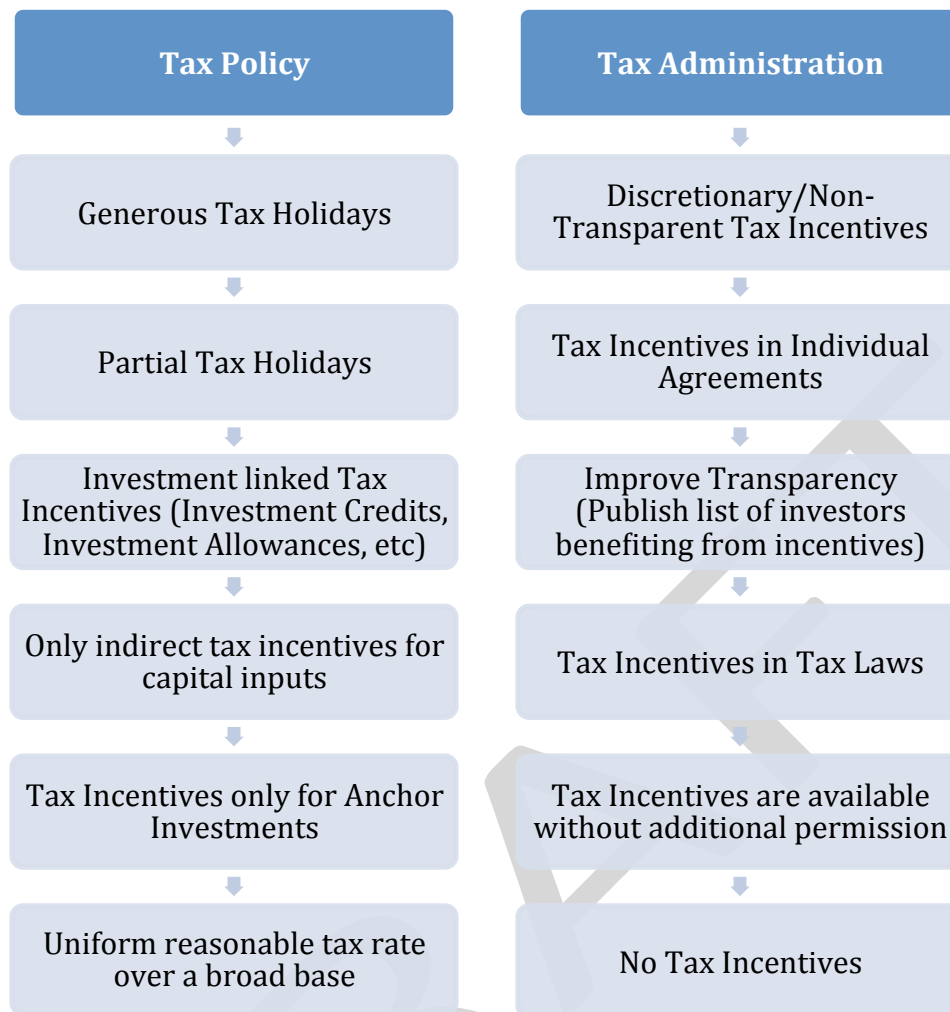
Thus tax holidays are a very blunt investment incentive. Other incentives could provide benefits to taxpayers while encouraging investment. Such incentives, known as investment-linked or performance-based incentives, include:

- *Investment tax credit*—deducting a fixed percentage of an investment from tax liability. Rules differ about credits in excess of tax liability and include the possibility that they will be lost, carried forward, or refunded.
- *Investment allowance*—deducting a fixed percentage of an investment from taxable profit (in addition to depreciation). The value of the allowance is the product of the allowance and the tax rate. So, unlike a tax credit, its value will vary across firms unless there is a single tax rate. Moreover, the value is affected by changes to the tax rate, with a tax cut reducing it.
- *Accelerated depreciation*—allowing depreciation at a faster schedule than is available for the rest of the economy. This can be done in many ways, including through higher first-year depreciation allowances or increased depreciation rates. In nominal terms tax payments are unaffected, but their net present value falls and the liquidity of firms increases.

The diagram below illustrates a progressive evolution towards a sound, measured and targeted use of tax incentives.

Figure 15: Reform Part for Tax Policy and Administration

¹⁰⁵ James, Sebastian, 2007, “The Effect of Tax Rates on Declared Income: An Analysis of Indian Taxpayer Response to Changes in Income Tax Rates,” Ph.D. diss., Harvard University, Cambridge, Mass.



Source: Adapted from James - 2013

Providing incentives can create risks that might have implications for the investment climate and overall fiscal compliance. It might encourage lobbying and rent seeking. Increasing transparency on the costs and benefits of tax incentives would, in the long run, help frame future policy. Providing a level playing field to all businesses through broad based taxes and with reasonable rates has been the best investment incentive in many countries.

General best practices for government design of fiscal and other incentives

More broadly pertaining to fiscal and other incentives, there are techniques governments can adopt in order to try to tailor incentives to their policy aims and maximize the effectiveness and efficiency of those incentives. These include providing incentives that are:

- **tied to performance criteria rather than unconditional, with mechanisms for monitoring and enforcement:** Governments can condition grant of incentives to compliance with specified

requirements, ranging from basic obligations to comply with host state law, to more substantive requirements on investment targets, R&D, or employment and training; the relevant law, regulation, or contract can then specify that failure to comply can or will result in a loss of incentives for future operations, or even a duty to repay (potentially with interest) the incentives already granted (or their equivalent value).

- **back-loaded rather than front-loaded:** Incentives can be provided for up front (“front loaded”) before the investment and any targets are met or over a period of time (“back loaded”) once the investment and any targets are met. Front loading might increase the benefit calculus done by the firm and increase the net present value, but it exposes governments to the risk that incentives will have been paid but anticipated benefits never materialized. Back loaded investment incentives protect governments and obviate the need to use “claw backs” for unfulfilled agreements (Thomas, 2012:14)
- **rule-based rather than negotiated or ad hoc:** Governments can provide incentives through development and application of clearly defined, transparent, and objective eligibility criteria, deals negotiated on a discretionary and bilateral basis, or an approach that lies somewhere in between those two poles. The less the grant of incentives is tied to a pre-defined, public, and rule-based system, the more vulnerable it will be to skewing through corruption, information asymmetries, and disparities in bargaining power. In contrast, establishing incentives programs in generally applicable laws and regulations, and setting forth the parameters of when and under what circumstances they will be granted, helps ensure that they are and remain appropriately tailored to further identified policy objectives. For instance, governments should place tax incentives in the relevant tax code so that tax authorities can administer them. If relevant tax clauses cannot be moved to the tax law, they should at least be mirrored or copied there. Doing so unambiguously allows the tax administration to administer tax incentives and limit their abuse.

A recent review of 28 investment projects that were granted EU State aid for regional development illustrates the role of those techniques, indicating that they are being employed, but not fully or by all granting authorities, leaving projects without adequate ex-ante economic assessments or ex-post evaluations.¹⁰⁶ This review covered projects in six industries and seven member states that were carried out between 2002 and 2010. The case studies included (1) seven investment projects in the pharmaceutical industry in Ireland; (2) three investment projects in the solar industry in Germany; (3) three investment projects in the car industry in Slovakia and Hungary; (4) eight investment projects in internal business services in Poland; (5) two investment projects in the cement industry in Hungary; and (6) five investment projects in the pulp and paper industry in Spain and Portugal.

Among the study’s findings are that certain agencies are more diligent about conducting cost-benefit analyses of projects and incentives offers than others, but that in no case was there actually a careful

¹⁰⁶ Ramboll & Matrix, Ex-Post Evaluation of the Regional Aid Guidelines 2007-2013, Final Report (Dec. 2012), at 8, available at: http://ec.europa.eu/competition/consultations/2013_regional_aid_guidelines/study_rag_evaluation_en.pdf.

review of the “incentive effect” – i.e., whether the incentive would impact investors’ investment or locational decisions. It also determined that while some jurisdictions controlled the discretion of the granting authority to negotiate and renegotiate incentives packages, others took a more flexible approach, loosening controls over efforts to ensure the incentives provide value for money and were used to meet intended objectives. A summary of the key findings is contained in Box 8.

Box 8: Lessons from the EU Regulation of State Aid, 2007-2013: Findings from the ex-poste evaluation of regional aid guidelines and their implementation in 28 investment projects in seven member states

What are the general procedures and criteria for granting aid?

Regional aid schemes are designed in accordance with pre-defined national regional development strategies identifying priority sectors, types of projects and regions. Individual aid projects are generally evaluated against these schemes.

Granting authorities offer a variety of aid schemes, differing, e.g., in terms of the type of eligible expenditures to be covered and the form of aid to be provided.

Who decides whether to grant the aid and what policy implications does that have?

Different authorities at different levels of government have authority to grant aid.

Where decisions are made at the regional level as opposed to national level, there appears to be an increased risk of a “race to the bottom” (e.g., efforts to attract pharmaceutical companies in Ireland v. solar industry in Germany)

What is the ex ante process prior to an incentive decision?

- In no case was there evidence that ex ante project evaluation carefully considered the effect the incentive would have on an investment or location decision.
- In terms of deciding on the amount of aid to be provided, practices differed significantly from one granting authority to another, with the most structured approach being in Poland and the least in Germany.
- All granting authorities except for the Polish granting authority negotiated the level of the incentive provided. The bargaining power of the firm vis-à-vis the government was strengthened if (1) the potential value for the regional economy was high and (2) there was a high probability that, in the absence of the state aid, the investment would move to another country.

How much aid was given and what were its terms?

- The level of aid varies significantly from one case study to another, as does the extent to which awarded aid reaching the maximum permitted level set by the EU’s guidelines on regional aid.
- In Ireland, Poland and Slovakia, authorities made payment of aid conditional upon the achievement of objectives relating to job creation. Ireland strictly applied the rules and refused to renegotiate when targets were not met, while Poland was more flexible and renegotiated at least one deal.
- In Germany, Spain and Portugal, there were examples of cases in which aid was fully paid even though the objectives were not completely achieved.

What is the connection between aid intensity and incentive effect?

- A low or nonexistent incentive effect will translate into low or no value for money. High aid intensity would thus not be recommended for a project with a low incentive effect.

- In these case studies, except for the case of Hungary/cement, there was a link between the aid intensity and the incentive effect, with a low aid intensity for projects with low incentive effects. (See Appendix 4, Table 19).

- Only one case study (Hungary/cement) clearly failed to provide value for money. There was a low incentive effect and the project promised little in the way of agglomeration effects or linkages. Nevertheless, authorities gave the project a significant amount of aid.

- Other aid was provided where there was little or no incentive effect (Poland/business services and Ireland/pharmaceuticals), but where the aid values were also low and tied to achievement of certain obligations, thus helping to link benefits (direct and indirect) to costs.

- In two cases there was a moderate incentive effect (solar/Germany and automotive Hungary/Slovakia):

* The investment per job ranged from roughly €50,000 in the car industry in Slovakia and Hungary to €200,000 in the solar industry.

* In both cases, incentives reached the maximum amount of aid allowed under the relevant aid ceiling.

- In Germany, there was an indication that there was a subsidy race within the country, though the aid ceilings likely prevented that from being a race to the bottom. If aid ceilings were raised, the amount of the incentive might also have increased. If they were lowered, however, there is a chance that the investment would have been lost to other potential locations in the China and the US.

What are the implications outside the jurisdiction of the granting authority? The study reviewed the potential impacts of the incentives on the EU more broadly, noting that those effects were more challenging to gauge, particularly due to complexities in understanding whether jobs created in these areas using regional aid resulted in job loss in other parts of Europe and/or would strengthen the competitiveness of the relevant firms over time.

Source: Ramboll & Matrix, Ex-Post Evaluation of the Regional Aid Guidelines 2007-2013, Final Report (Dec. 2012)¹⁰⁷

Overall, whatever tax and non-tax incentives a government decides to offer and however it structures them, every effort should be made to ensure that they are:

- *Affordable*—forgone income or other grants should not severely undermine government revenue streams or burden budgets.
- *Targeted*—targets for incentives should be based on research to confirm that they will benefit the country in ways that would not have been possible if there were no incentives, thereby reducing revenue costs.
- *Simple*—incentive administration should permit easy accessibility and determination of eligibility.

¹⁰⁷ http://ec.europa.eu/competition/consultations/2013_regional_aid_guidelines/study_rag_evaluation_en.pdf.

- *Reviewed periodically*—investment incentives should be regularly reviewed to determine their relevance and economic benefit relative to their budgetary and other costs, including long-term impacts on resource allocation.

Section 4: Reducing incentives competition – global regulatory efforts to limit “races to the bottom”

There are several factors and trends that are driving the use of inefficient incentives:

- **asymmetries in information** and inequality in **bargaining power** between governments and firms. Governments are unable to know what incentives packages competing jurisdictions are offering;
- **the growing use of site consultants**, which in some markets can strengthen those asymmetries and the extractions of “rent”;
- **misalignment of costs and benefits** – with the benefit of attracting an investment being “booked” for the government officials in office at the time, but the costs often pushed off onto future governments;
- **the absence of a counterfactual** – i.e., the inability for a government to always know what would have happened if it did not grant the incentive, or provided a smaller incentive package; and
- **the increasing mobility of capital** making it more difficult for governments to get investments to “stick”.

While the winning location may reap near-term benefits from securing an investment, it does so at a cost likely higher than it would have been absent any unnecessary incentives competition. This can lead to a situation in which the offer and receipt of incentives becomes the norm, rather than the exception, benefitting investors at the expense of general welfare.

Addressing these issues, however, is a problem of collective action. An individual city, state, nation or even region does not want to restrain its ability to use incentives to obtain an advantage over other competing jurisdictions, particularly if other jurisdictions have not similarly committed to restrict use of incentives. Through each actor pursuing its own self-interest in the effort to attract investment, it encourages a race-to-the bottom detrimental to all.¹⁰⁸

There are some examples of treaties that aim to address these collective action problems and restrict use of trade distorting practices caused by unnecessary or excessive government support or assistance. Two prime examples are the WTO’s Agreement on Subsidies and Countervailing Measures (SCM) and European treaties governing State aid. These treaties were originally aimed to primarily address issues of cross-border trade, and thus may not have been designed specifically to

¹⁰⁸ See Thomas, K.P., 2011, *Investment Incentives and the Global Competition for Capital*. Palgrave Macmillan: USA.Ch. 2, for a more thorough description of these issues.

address the use of incentives to attract investment (or support outward investment). However, their rules do apply to the granting of subsidies and aids used to attract investment. Moreover, some more recent treaties – agreements that were designed specifically to govern and address international investment – also contain rules relevant to the use of investment incentives. These instruments are described in more detail below.

SCM Agreement

The SCM Agreement governs the use of subsidies relating to trade in goods (not services). It is the only multilateral agreement containing a definition of a “subsidy”, defining the term as a “financial contribution”, or price/income support “by a government or any public body”, which confers a “benefit” on the recipient. The two key elements of that definition are thus that a “subsidy” must (1) include a financial contribution by the government or charge on the public account, and (2) convey a benefit the recipient would not have enjoyed under normal market conditions.

Financial contribution. With respect to the first element, the SCM Agreement sets forth an exhaustive list of the types of financial contributions that can be subsidies. These are:

- direct transfer of funds (e.g. grants, loans and equity infusion), and a potential direct transfer of funds or liabilities (e.g. loan guarantees);
- government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits);
- provision of goods or services (other than general infrastructure), or government purchases of goods, at non-market prices;
- government payments to a funding mechanism, or when government entrusts or directs to a private body to carry out one or more of the three types of contributions addressed above.

Regulations (e.g., exemptions from having to comply with certain environmental or technical standards) that convey an indirect benefit on firms or industries are not in that list and thus would not fall within the SCM’s definition of a subsidy.

In addition to the exhaustive list of financial contributions that can constitute subsidies, the SCM Agreement includes in the definition of a subsidy income or price supports that directly or indirectly increase exports from or reduce imports into a member state’s territory.

Benefit. The second core element of the definition of a “subsidy” under the SCM Agreement is that it must confer a benefit or advantage on the recipient. An “advantage” is defined in relation to the normal costs and benefits occurring in the market;¹⁰⁹ and a benefit or advantage is conferred if the financial contribution “places the recipient in a more advantageous position than would have been the case but for the financial contribution.”¹¹⁰

¹⁰⁹ A benefit does not always need to be established under the SCM. Since the SCM Agreement contains an illustrative list of export subsidies, which if met, does not require a benefit to be established separately.

¹¹⁰ Canada—Aircraft, Panel Report, paras. 9.112-9.113; see also Canada—Aircraft, Appellate Body Report, (WT/DS70/AB/R, 2 August 1999), at para. 155.

Regulation of specific subsidies

If a measure falls in the definition of a “subsidy” that does not mean that the subsidy will then be prohibited or restricted under the SCM Agreement. Whether and to what extent the subsidy will be regulated depends on its “specificity”. “Specificity” refers to whether a subsidy is generally available for all enterprises and industries within a region or granted to only a particular enterprise, industry, or group of enterprises or industries. By bringing only “specific” subsidies under the coverage of the SCM Agreement, WTO members aim to target only those subsidies that “[c]ause distortions and inefficiencies in international trade and [that], therefore, should fall under an international discipline. General measures, such as the reduction of tax rates for an entire country or the creation of public infrastructure, modify the market structure in the same way for all economic operators in the market” and are not restricted.¹¹¹

If a subsidy is “specific” it may fall under one of three different categories, each of which has different implications for whether the subsidy can be used and when and what measures or remedies are available to other states. These three categories are (1) export subsidies, which are deemed specific and flatly prohibited; (2) domestic or industrial subsidies, which are actionable but not flatly prohibited; and (3) non-actionable subsidies.

With respect to that first category, the SCM Agreement states that prohibited export subsidies are:

- (a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance....; [and]
- (b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.¹¹²

Specific subsidies that are not flatly prohibited, but that are “actionable” by other states are those that cause:

- (a) injury to the domestic industry of another Member;
- (b) nullification or impairment of benefits accruing directly or indirectly to other Members under GATT 1994....; [or]
- (c) serious prejudice to the interests of another Member.¹¹³

Finally, certain specific subsidies were designated as “non-actionable” under the SCM Agreement. One category was *de minimis*¹¹⁴ subsidies deemed to have insignificant impacts on international trade.¹¹⁵ Other non-actionable subsidies were three categories of subsidies frequently used by

¹¹¹ Luengo at 129.

¹¹² SCM Agreement, Art. 3.

¹¹³ SCM Agreement, Art. 5.

¹¹⁴ The *de minimis* rule was introduced in order to exempt small aid amounts. It sets a ceiling below which aid is deemed not to fall within the scope of Article 107(1) TFEU and is therefore exempt from the notification requirement laid down in Article 108(3) TFEU. Aid of no more than EUR 200 000 granted over a period of three years is not regarded as state aid within the meaning of Article 107(1) TFEU. A specific ceiling of EUR 100 000 applies to road transport.

¹¹⁵ SCM Agreement, Art. 6.

relatively rich nations: those designed to support or promote R&D, to assist disadvantaged regions within a member state, and to promote adaptation of existing facilities to new environmental regulations.¹¹⁶ The protections for those subsidies, however, expired in 1999.¹¹⁷

Subsidies used by developing countries

The SCM Agreement includes specific rules for developing country members, allowing them more flexibility to use export and domestic subsidies to advance their development goals.¹¹⁸ The provisions in the SCM Agreement relating to developing countries permit them to grant otherwise-prohibited export subsidies (though for many countries, these special provisions have expired)¹¹⁹ and enable them to use domestic subsidies to support privatization.¹²⁰ The SCM Agreement also sets out special rules regarding countervailing duties, broadening the category of subsidies that are deemed to be de minimis and incapable of justifying such levies.

Notification and review

The SCM Agreement requires that all specific subsidies (including those that are non-actionable) be disclosed on an annual basis. Any party may ask another for more specific information about its subsidies and, if the requested party does not comply, the requestor may bring the matter to the attention of the SCM Committee – a body established by the Subsidies Code to help monitor and support compliance with the subsidies rules. The SCM Committee is also required to examine states' notifications every third year.

There are no sanctions or other consequences for a member's failure to notify a subsidy.

Penalties and remedies

There are a number of penalties and remedies in response to the granting of a prohibited or actionable subsidy. These can be sought at the multilateral level, through the WTO's dispute settlement body, or taken unilaterally, by a state's imposition of countervailing duties, with each route having different implications. Unilateral action via countervailing duties, for instance, will only neutralize the effect of the subsidy in the member state imposing the countervailing duties, and does not eliminate either the subsidy or its effects on third countries. In contrast, if the subsidy is challenged through the WTO's dispute settlement procedures, a panel will decide the validity of the measure under the SCM Agreement and may order or recommend that the member withdraw the subsidy.

The type of subsidy affects the relevant remedy: if a prohibited subsidy has been found by the WTO's dispute settlement body (DSB), it will order the member to withdraw the subsidy, and may

¹¹⁶ The SCM Agreement sets forth specific requirements for subsidies to meet to fall within these categories of non-actionable measures. SCM Agreement, Art. 8. In addition to these categories of non-actionable subsidies, there are also some export subsidies that are excluded from being categorized as such pursuant to Annex I of the ASCM Agreement. Luengo, at 165.

¹¹⁷ SCM Agreement, Art. 31.

¹¹⁸ Luengo, at 201.

¹¹⁹ SCM Agreement, Art. 27.2.

¹²⁰ SCM Agreement, Art. 27.13

also require repayment of the subsidy granted. If the subsidy is actionable (not prohibited), but has caused adverse effects in another member state or states, the member granting the subsidy may either withdraw it or take action to eliminate those effects, such as by providing compensation.

WTO Agreement on Agriculture (AoA)

Certain provisions of the SCM Agreement do not apply to trade in agricultural commodities, with those issues governed by a separate WTO text, the AoA. In turn, the AoA has established a detailed regime governing “export subsidies” and “domestic production”.

Export subsidies

“Export subsidies” under the AoA are:

- (a) the provision by governments or their agencies of direct subsidies, including payments-in-kind, to a firm, to an industry, to producers of an agricultural product, to a cooperative or other association of such producers, or to a marketing board, contingent on export performance;
- (b) the sale or disposal for export by governments or their agencies of non- commercial stocks of agricultural products at a price lower than the comparable price charged for the like product to buyers in the domestic market;
- (c) payments on the export of an agricultural product that are financed by virtue of governmental action, whether or not a charge on the public account is involved ...;
- (d) the provision of subsidies to reduce the costs of marketing exports of agricultural products (other than widely available export promotion and advisory services) including handling, upgrading and other processing costs, and the costs of international transport and freight; [or]
- (e) internal transport and freight charges on export shipments, provided or mandated by governments, on terms more favourable than for domestic shipments;
- (f) subsidies on agricultural products contingent on their incorporation in exported products.¹²¹

Export subsidies that are “scheduled” by WTO members are subject to reduction commitments requiring decreases in both the amount of subsidy granted and the amount of products subsidized. Non-scheduled export subsidies are prohibited. Reduction commitments are stricter for developed than developing countries, and do not apply to least developed countries.

¹²¹ AoA, Art. 9(1).

While in 2005 trade ministers set 2013 as the year by which all agricultural export subsidies were to be phased out, talks necessary to meet that objective have thus far not produced an agreement on the issue.¹²²

Domestic supports

In addition to export subsidies, the AoA regulates domestic subsidies, and does so by grouping them in different colored “boxes” according to the trade-distorting impact they are deemed to have:¹²³

- Amber box subsidies: These are measures deemed to be highly trade distorting. Amber box measures, which include price-support subsidies or subsidies directly relating to production quantities, are generally subject to reduction commitments which are stronger for developed than developing countries. Amber box subsidies by least developed countries are not restricted.
- Blue box subsidies: These are measures that are less trade-distortive. Blue box measures include subsidies such as price supports that would otherwise be deemed as amber box subsidies, but that are made contingent on farmers *limiting* (as opposed to exporting or increasing) production; such “production-limiting” conditions are considered to have less price-suppressing effects, and thus do not require control through reduction commitments;
- Green box subsidies: These are measures that are considered to have no or only a minimal impact on trade. To fall within this box, subsidies must (a) “be provided through a publicly-funded government programme (including government revenue foregone) not involving transfers from consumers;”¹²⁴ (b) “not have the effect of providing price support to producers;”¹²⁵ and (c) must be used for and meet criteria regarding specific policy purposes or objectives, including promoting food security,¹²⁶ providing food aid,¹²⁷ or providing support for relevant services such as R&D, extension and advisory services, and infrastructure services.¹²⁸ Green box measures are not disciplined under the AoA.

WTO General Agreement on Trade in Services (GATS)

In contrast to the SCM Agreement (which relates to trade in goods) and the AoA (which relates to agricultural products), the GATS contains only limited provisions on subsidies.

¹²² Hong Kong Ministerial Declaration, 18th December 2005, http://www.wto.org/english/thewto_e/minist_e/min05_e/final_text_e.htm, para. 6.

¹²³ AoA, Art. 6.

¹²⁴ AoA, Annex 2(1)(a).

¹²⁵ AoA, Annex 2(1)(b).

¹²⁶ AoA, Annex 2(3).

¹²⁷ AoA, Annex 2(4).

¹²⁸ AoA, Annex 2(2).

Article XV of the agreement, which is the article specifically devoted to subsidies, contains no rules actually restricting their use.¹²⁹

Other GATS provisions, however, are also relevant and may have a stronger disciplining effect on their use:

- Article II, the most-favoured nation clause, restricts a host country's ability to treat foreign investors from one WTO member less favourably than foreign investors from another WTO member with respect to their investments in services; this obligation applies to all measures (including the provision of subsidies) and service sectors unless the government adopting the measure has listed an appropriate exemption;
- Article XVII, the national treatment clause, restricts a country's ability to treat foreign investors less favourably than domestic investors with respect to their investments in services. This obligation only applies to service sectors that have been listed in a country's schedules; and, for those sectors that are listed, states may still take exceptions enabling them to grant different treatment to foreign and domestic investors;
- Article XVI, on market access commitments, is the provision through which WTO members commit to enable investors from other WTO member to invest in their domestic service sectors; absent such a commitment, there is no obligation to allow a foreign firm to establish or operate a presence within its territory. When making market access commitments, a country may limit its permission by, for instance, stating that the foreign investor will not be allowed if subsidized, or subsidized over a certain level, by its home government.
- Article XX(1)(c) allows WTO members to make "additional commitments" regarding trade in services and could thus be used as a basis for establishing additional disciplines on the use of subsidies or incentives; and
- Article XXIII(3) provides that a member may invoke dispute settlement processes if it contends that actions of another member (including use of a subsidy) impair or nullify benefits it reasonably expected to receive under the GATS.

4 - Treaty on the Functioning of the European Union (TFEU) and Rules on State Aid

The overarching rules on State aid are currently set forth in Articles 107 through 109 of the Treaty on the Functioning of the European Union (TFEU). These provisions are brief and provide limited guidance, so communications, guidelines and decisions by the European Commission, as well as judgments of the European Court of Justice (ECJ), play a crucial role in elaborating the substantive content of the standards. There is now a relatively robust body of rules and guidelines governing the

¹²⁹ Instead, it notes that WTO members "recognize that, in certain circumstances, subsidies may have distortive effects on trade in services" and shall share information and "enter into negotiations with a view to developing the necessary multilateral disciplines to avoid such trade-distortive effects." If one Member state "considers that it is adversely affected by a subsidy of another Member," Article XV(2) provides simply that the affected Member "may request consultations with [the subsidizing] Member on such matters" and that the request "shall be accorded sympathetic consideration."

use of State aid and providing guidance regarding when and under what circumstances it will be allowed, including with regard to support for inward and outward investment.

Through application of these rules and guidelines, granting of State Aid by European countries has been in decline as explained in Section 2. Constituting roughly 2% of GDP in the 1980s, they now are roughly 0.5% of GDP.¹³⁰

EU definition of State aid

As noted above, State aid regulated by EU law is (Article 107(1)): (1) aid, in any form whatsoever, which confers an advantage or benefit for the recipient; (2) granted by a Member State or through State resources; (3) that distorts or threatens to distort competition by favoring certain undertakings¹³¹ or the production of certain goods; and (4) affects trade between Member States. All four elements must be met in order for government assistance to count as State aid.

Contribution of state resources. Decisions of the European Court of Justice interpreting the rules on State Aid have held that it must involve a direct or indirect transfer of state resources, or a charge on the public account.¹³² Price and income supports not paid through public funds consequently would not constitute State aid, nor would actions by the government directing a private body to make a payment or forego income otherwise due.

Advantage. To determine whether the recipient has been granted a benefit or advantage requires application of a market test – i.e., determining whether the same advantage would have been available under market conditions. Advantages can be granted through a wide range of interventions, including through government participation in a company's capital, the granting of loans or guarantees, tax relief, exemptions from social welfare charges, provision of goods or services, and payment for goods and services.

Selectivity. The advantage must favour certain undertakings or the production of certain goods or services. Hence, subsidies which are granted to individuals, or general measures open to all enterprises, are not prohibited and do not constitute State aid (e.g. general taxation measures or employment legislation). Overall, the notion of selectivity as interpreted by the European Court of Justice is quite broad and “embraces all measures that are not of general application,”¹³³ or “general economic support measures”¹³⁴. However “a measure that is open to all sectors may be selective if

¹³⁰ Thomas, K.P., 2011, *Investment Incentives and the Global Competition for Capital*. Palgrave Macmillan: USA., ch. 8, at p. 10; EU Scorecard, 2012 at 7. These figures are limited to non-crisis State Aid. The aid to the financial sector in 2011 was 714.7 euros, or 5.5% of EU GDP. EU Scorecard, 2012 at 8.

¹³¹ An undertaking is any entity (this includes legal persons, such as a company, and individuals acting as sole traders) which is engaged in an economic activity (C-303/88 Italy v Commission 1991 ECR I-1433). An economic activity is “any activity consisting of offering goods and services on a given market” (C35/96 – Commission v Italy 1998 ECR I-03851). When an organisation is carrying out an activity for which it is capable of being remunerated and competing against other organisations within a market, it will be an undertaking for the purposes of State Aid. The Commission applies the undertaking test very narrowly. It does not take into account whether a fee is charged or whether the amount of profit is appropriate. Neither does it consider whether the organisation has charitable aims or other social objects. Public sector organisations that have engaged in an economic activity have been found to be undertakings. (Italy v Commission, 1991 ECR I-1433).

¹³² Luengo at 326-27. Luengo suggests, however, that the European Commission has indicated it takes a different view of this subject.

¹³³ Ehlermann and Goyette, 2006:703.

¹³⁴ http://ec.europa.eu/competition/state_aid/studies_reports/conceptual_remarks.html

there is an element of discretion by the awarding authorities”, and if the scheme applies to only part of the territory of a Member State (this is the case for all regional and sectoral aid schemes).¹³⁵

Regulation of specific subsidies

Support meeting the definition of State aid is generally considered to be incompatible with the common market and not allowed unless it is aimed at one of several Community objectives or corrects certain market failures.

Article 107(2) of the TFEU, lists three categories of State aid that are always permitted, in order to achieve certain policy goals of the Community:

- aid with a “social character” granted directly to individual consumers, as long as it is granted without discrimination relating to the origin of relevant products (e.g., tax deductions for low-income or disabled persons, or tax benefits for purchase of low-carbon products);
- aid to repair damage caused by natural disasters or other exceptional occurrences; and
- aid granted to certain parts of Germany to compensate for economic consequences of the former division of the country.

Article 107(3) then provides that there are several other objectives that may, in certain cases, also warrant use of State aid. In this case, the Commission has discretion regarding whether to authorize State aid targeting any one of these policy goals:

- furthering economic development of areas where the standard of living is abnormally low or where there is serious underemployment as compared to EU averages; (Art. 107(3)(a))
- promoting important projects of common European interest (e.g., construction of a power plant to provide energy to other EU members, construction of infrastructure linking EU states, the formulation of industrial standards and environmental protection); or to remedy a serious disturbance in the economy of a member state that affects the state as a whole (as opposed to just certain regions or sectors); (art. 107(3)(b))
- facilitating the development of certain economic activities or certain economic areas (regions that are economically disadvantaged relative to the state in which they are located), provided that such aid does not adversely affect trading conditions to an extent contrary to the common market; (Art. 107(3)(c))
- promoting conservation of culture and heritage; (Art. 107(3)(d)) and
- achieving other goals specified by decision of the Council acting on a proposal by the Commission. (Art. 107(3)(e))¹³⁶

The Commission has issued guidelines specifying the criteria that must be satisfied in order for aid under Article 107(3) to be allowed.¹³⁷ These are:

- contribution to a well-defined objective of common interest;

¹³⁵ http://ec.europa.eu/competition/state_aid/studies_reports/conceptual_remarks.html#what_is

¹³⁶ For a useful discussion of these criteria, see Luengo at 346-378.

¹³⁷ These guidelines issued in 2013 will cover the period from 2014 to 2020. European Commission, Guidelines on Regional State Aid for 2014-2020, Official Journal of the European Union, 209/01 (July 23, 2013).

- need for state intervention: a State aid measure must be targeted towards a situation where aid can bring about a material improvement that the market cannot deliver itself, for example by remedying a market failure or addressing an equity or cohesion concern;
- appropriateness of the aid measure: the proposed aid measure must be an appropriate policy instrument to address the objective of common interest;
- incentive effect: the aid must change the behaviour of the undertaking(s) concerned in such a way that it engages in additional activity which it would not carry out without the aid or it would carry out in a restricted or different manner or location;
- proportionality of the aid: the aid amount must be limited to the minimum needed to induce the additional investment or activity in the area concerned;
- avoidance of undue negative effects on competition and trade between Member States: the negative effects of aid must be sufficiently limited, so that the overall balance of the measure is positive;
- transparency of aid: Member States, the Commission, economic operators, and the public, must have easy access to all relevant acts and to pertinent information about the aid awarded thereunder.

In addition to these overarching principles, for each of the types of potentially permissible categories of State aid referred to in Article 107(3) the Commission and the ECJ have developed more specific guidance regarding the scope and nature of support that may be allowed.

For instance, to determine whether to authorize regional aid, the Commission has developed precise rules that specify appropriate levels of aid intensity. These levels vary based on the extent of the economic disadvantage in the targeted region as well as the size of the investment. The more severe the economic situation in the relevant region, the greater the allowed aid intensity will be. The maximum aid intensity for small- and medium- sized enterprises can be greater than it is for large firms. If the investment project is deemed a “large investment project” because it exceeds a threshold value, the maximum aid intensity is lower than the standard maximum allowed for investment support in that region, and will be further lowered as the value of the investment increases. Commission guidance also provides that regional aid is generally only permitted to support establishment of a *new* enterprise or the expansion, diversification or upgrading of an existing one. Regional aid is only rarely allowed if it is designed to cover operating expenses of an existing investment.

Application of these rules has led to the withdrawal of a number of investment incentives:

[T]he Commission in 2005 informally indicated to the Irish government that it would not approve a proposed €170 million aid to Intel for a €1.6 billion chip fabrication plant at Leixlip, and the Irish authorities withdrew the aid notification. ... Similarly, in 2008 an EU decision ... to open an investigation of a proposed investment subsidy of €37.4 million to steel-maker Dunaferri prompted Hungary to withdraw the aid proposal. And in 2002, the

UK withdrew a proposed £17.4 million aid to Ford after the Commission opened an investigation under [State aid regulations].¹³⁸

Application of these rules has also led Ireland to reorient its FDI incentive policy (see Box 9)

Box 8: Ireland's use of FDI and investment incentives

Over the past 50 years, Irish development policy has evolved on a continuous basis from fostering import protectionism with high tariffs and barriers against inward foreign direct investment (FDI) to supporting and promoting export growth and FDI (Buckley and Ruane, 2006).

Promotion of export-oriented FDI began in the 1950s, prior to the reduction in tariff protection, which occurred in two phases – over the late 1960s/early 1970s vis a vis the UK, Ireland's major export market, and from 1970-1980 vis a vis the European Economic Community (EEC). The growing export sector reduced the negative employment effects of downsizing and closures of many import-substituting enterprises. From 1973 membership of the EEC enhanced Ireland's attractiveness as an export base for Non-European (mostly US) multinationals by providing easier access to large and growing European markets.

A key feature of Irish industrial development policy has been its enterprise level focus –grant supports have always been awarded on a discretionary basis, negotiated subject initially to domestic rules and limits and since the late 1970s to EEC/EU rules/limits. The level of grants given depended on the perceived value of the enterprise to Ireland – employment created, skill intensity, potential for spillovers, local value added, etc. In supporting this approach, the Industrial Development Authority (currently called IDA Ireland) became a highly sophisticated player in the market for globally-mobile investment projects. The other key features of Irish industrial policy have been its low corporate tax rate, supported by an extensive range of double taxation agreements, and its continuing evolution in response to domestic circumstances and global developments. If enterprises ceased to be competitive, the strategy was to find new replacement business rather than to shore up uncompetitive enterprises. In contrast to the grant supports, preferential tax rates were initially available automatically to all enterprises in manufacturing on their profits arising from exports, at a zero rate. Subsequently a ten percent rate was available on all profits of enterprises, both manufacturing and services, whose outputs were defined as 'internationally tradable'. During the 1990s, this extended to all corporate profits to meet EU State aid rules, at a rate of 12.5 percent.

Over the five decades, sectoral priorities were identified based on systematic analyses of global growth patterns and the changing degrees of tradability of products and services: in electrical engineering (1960s), in electronics and chemicals/ pharmaceuticals (1970s), in communications, computer software, and medical devices (1980s), and in the 1990s in bio-pharma and financial

¹³⁸ Thomas, K.P., 2011, *Investment Incentives and the Global Competition for Capital*. Palgrave Macmillan: USA, Ch. 8, pp. 7-8 (internal citations omitted).

services (created around the Irish Financial Services Centre). Since 2000, there has been an increased focus on global services (business, engineering, consumer) and on high-end manufacturing as well as on all enterprises engaged in R&D- and technology-driven innovation. An advantage of these latter activities is that EU competition regulations allow them to be grant-aided and they have potential to link innovation developments into the research activities in Irish universities (Newman, 2011)

Despite serious damage to its reputation in the recent crisis, Ireland has continued to win major FDI projects in ICT and digital media, life sciences, engineering, business services, and financial services. Furthermore, many existing FDI enterprises have won mandates for new investments in Ireland associated with product development. This continued success has meant that FDI exports have tempered the economic downturn which saw unemployment rise from 4 to over 14 per cent. FDI employment in Ireland is now back to pre-recession levels with the sector employing more than 150,000 people directly and accounting for the bulk of Irish exports of goods and services (Brennan and Verma, 2010). FDI continues to play a key role in Ireland's economic development strategy, building on its success in winning investments from major global multinationals, its EU membership, its growing skills and R&D base and its currently favourable tax regime. In October 2013 Ireland indicated its determination to ensure that any Irish registered company cannot be 'stateless' for tax purposes.

Source: Frances Ruane and Economic and Social Research Institute (ESRI)

Notification and review

With certain exceptions, Member States must notify the European Commission and seek prior approval of new State aid they intend to grant or amendments to existing State aid. Elements that must be notified include the authority granting the subsidy, the intended beneficiaries, their locations and sectors, the amount, form and source of the aid, and its objectives.

The exceptions to these requirements for prior notification and approval are for:

- State aids covered by a "block exemption";¹³⁹
- de minimis aid, defined as aid to a single recipient that does not exceed the value of 200,000 euros over a three-year fiscal term;¹⁴⁰ and

¹³⁹ See, e.g., Commission Regulation No. 800/2008 of August 6, 2008 (establishing block exemptions for certain aids to small- and medium-sized enterprises, aids supporting R&D, environmental protection, employment and training, and aid complying with the Commission's regional maps). In 2013, the Council adopted Regulation No. 733/2013 enabling the Commission to grant new block exemptions for aid for innovation, culture, natural disasters, sport, certain broadband infrastructure, social aid for transport to remote regions, and aid for certain issues relating to agriculture, forestry, and fisheries.

¹⁴⁰ The Commission is currently reviewing the de minimis block exemption regulation. Its proposal for a revised regulation to cover the period 2014-2020 contemplates maintaining the ceiling at 200,000 euros over the three-year period, but adding a mandatory registry for disclosure of de minimis aids. See, Draft Commission Regulation (EU) No. ____ of July 17, 2013 on the application of Articles 107 and 108 of the Treaty of the Functioning of the European Union on de minimis aid.

- individual aid granted pursuant to an “aid scheme”¹⁴¹ that had already been notified to and authorized by the Commission.

These exceptions apply to the majority of State aid. In 2011, roughly 88% of aid provided to industry and services was granted based on programs covered by a block exemption or previously approved aid schemes.¹⁴²

In addition to the disclosure requirements regarding new aid and amendments to existing aid, member states must also provide annual reports to the Commission on its existing aid schemes.

Penalties and remedies

The Commission has significant powers to monitor compliance with its decisions and the State aid rules. It can conduct on-site monitoring relating to existing aid programs, and review whether schemes in place continue to comply with relevant rules. Then, in cases where a member state has:

- (1) not notified a State aid, and that aid is later determined to be incompatible with the common market, or
- (2) notified the State aid and obtained approval, but implemented the aid in a manner contrary to the decision approving it,

the Commission may order the Member to terminate the scheme and *take all steps necessary to recover aid already granted*.¹⁴³

Intra-African Agreements

Various regional and economic blocks in Africa have made attempts at harmonizing their tax regimes with the aim of avoiding tax competition. However, these efforts have mostly been unsuccessful reflecting the difficulties of coordination problems.¹⁴⁴

One example is the effort toward tax harmonization in the West African Economic and Monetary Union (WAEMU). The eight members of this union have agreed on directives harmonizing various aspects of their tariff and tax regimes, including, in 2009, rules on income taxation. One recent study found, however, that WAEMU countries are granting investment incentives undermining those harmonization objectives. Whether acting through law or contract, officials in WAEMU countries

¹⁴¹ It is a tool for streamlining administrative procedures: an aid scheme has to satisfy the general conditions for State aid, it just then allows individual grants of aid to be given pursuant to that “scheme”.

¹⁴² EU Scorecard, at 12.

¹⁴³ There are some limits on these recovery orders. Recovery need not be done if it would violate a general principle of Community Law. Decisions by the Commission regarding the compatibility of aid with the common market, as well as orders to suspend aid or recover aid provided, can be appealed to the ECJ. National courts can review whether member states have complied with procedural requirements of the State aid rules such as obligations to notify aids. They cannot, however, review compatibility of aids with the common market or Commission decisions, and must annul any acts that the Commission determines constitute an unlawful grant of state aid. See discussion in Luengo at 403-404.

¹⁴⁴ Other initiatives include those by the Economic Community of West African States (ECOWAS), the Southern African Development Community. Outside of Africa, there have been relevant efforts by the Organisation of Eastern Caribbean States (OECS).

are taking advantage of institutional weaknesses and gaps in the relevant rules to give investments deals that deviate from their standard tax regimes, increasing the opacity and complexity of the tax systems, and “contributing to a culture of ‘tax negotiation.’”¹⁴⁵

The five-member East Africa Community (EAC) has recently made the most progress towards a “Code of Conduct” to harmonize member states’ tax incentive regimes. That Code, which is yet to be adopted, aims to formalize an existing arrangement whereby each year the finance ministers of the five countries that make up the EAC meet before their budget speeches are made and discuss their budget proposals. This provides the opportunity for Finance Ministers to dissuade other members if they propose any new tax incentive that puts other countries at a disadvantage. The Secretariat, through a series of studies, is currently working to drive investment harmonization by unifying the incentive packages offered to investors within the member states and removing the disparity among investors.¹⁴⁶

The Common Market for Eastern and South Africa (COMESA) also integrates regulations regarding incentives in the legal notice establishing its rules. Those regulations define what subsidies are, rules for notification and countervailing measures available in case of distortion of competition between the countries of the common market.¹⁴⁷

Last, the Southern African Development Community (SADC) is encouraging harmonization and cooperation between its member states, notably through the Finance and Investment Protocol (FIP).¹⁴⁸ Article 4 of the FIP stipulates “good practice Guidelines to avoid harmful tax competition & cost benefit analysis to protect regional revenue”. To focus efforts towards implementation of tax coordination, Ministers for Finance and Investment of the member states endorsed the formation of three technical working groups (WGs), one of them the tax incentives WG. This WG is engaged in developing guidelines for the governance of tax incentives in SADC. It has already issued three studies: measuring the effectiveness and economic impact of tax incentives in the Community (2004), developing guidelines for the application and treatment of tax incentives and a tax expenditure budgeting template (2007) and for the application and treatment of tax incentives (2012)¹⁴⁹. The SADC Guidelines were validated in July 2012. Their main recommendations are that 1) all new tax holidays are phased out and old ones grandfathered 2) there is a need for a shift from profit to investment based tax incentives and 3) the minimum corporate income tax is 10%. There is also a plan to develop a cost-benefit analysis model for incentives.

¹⁴⁵ Mario Mansour and Gregoire Rota-Graziosi, *Tax Coordination, Tax Competition, and Revenue Mobilization in the West African Economic and Monetary Union*, IFM Working Paper, WP/13/163 (June 2013), at 36; see also id. at 26-28.

¹⁴⁶ James, S. 2013, *Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications*. World Bank Investment Climate Advisory Services. September 2013.

¹⁴⁷ COMESA LEGAL NOTICE NUMBER 1 of 2009, Article 1, Article 22, 23 as reported in the Official Gazette: <http://www.comesa.int/attachments/article/26/2009%20Gazette%20Vol.%2015%20No1.pdf>

¹⁴⁸ http://www.taxcompact.net/documents/workshop-lusaka/2013-02-13_itc_Mathipa_SADC.pdf

¹⁴⁹ Effectiveness and Economic Impact of Tax Incentives in the SADC Region (Bruce Bolnick, 2004); Study to Develop draft Guidelines for the Application and Treatment of Tax Incentives and a Tax Expenditure Budgeting Template in SADC (Adrian Ogley, 2007); Study to Develop Guidelines for the Application and Treatment of Tax Incentives in SADC (Susan Himes, 2012) - Report was concluded, validated & formally adopted September 2012.

International Investment Treaties

International investment treaties are bilateral and multilateral instruments designed for the promotion and protection of international investment.

There are a number of connections between investment treaties and investment incentives that make these instruments relevant and important for international governance of FDI incentives. In particular, both are instruments used by governments to attract investment and promote outward investment. Investment treaties may even be seen as one form of regulatory investment incentive – by providing investors additional substantive and procedural legal protections, and restricting host countries’ abilities to interfere with their investments. Both instruments, however, are also criticized as: (1) not being effective in achieving their intended goals, or (2) if effective, effective at too high a price, and (3) with that price raising equity concerns, as it constitutes a transfer of wealth from the public to the private.

Aside from these broad overlapping features, there are important connections between investment treaties and incentives in that investment treaties may currently be driving and locking-in use of incentives, but also can and, to a limited extent already do, regulate use of such supports.

Investment treaties’ role in driving and locking in use of incentives

Investment treaties *affect capital mobility and intensify competition among governments to attract more footloose capital through use of incentives*. While many investment treaties only offer protection to foreign investment already within a state’s borders, a growing number of them provide foreign investors with rights to enter a foreign market and establish a commercial presence there, and guarantee the ability of investments and investors to freely transfer capital across borders. Additionally, broadly phrased definitions of “investments” and “investors” have been interpreted to protect investors and their overseas investments irrespective of whether the investor has substantial or real ties with the home country, or whether its foreign investment has made a lasting commitment to the host country. Investment treaties thus facilitate and protect the free movement of capital across borders, even where this may run counter to states’ needs for long-term, stable investment that can provide a reliable tax base, employment, and other benefits.

When incentives are granted in order to attract or keep this investment, investment treaties may lock them in irrespective of their efficiency or effectiveness in meeting policy goals or shifts in the needs, priorities and resources of governments. More specifically, after a government establishes an incentive program, it may wish to modify or eliminate that program if it runs into budget shortfalls, has to tackle new challenges and priorities, and/or determines that the incentives are not efficient or effective. Investment treaties, however, may limit governments’ abilities to amend or remove incentives programs once in place.¹⁵⁰ Foreign investors have alleged that the “fair and equitable treatment” standard and the obligation to pay compensation if there is any expropriation of an investor’s property – both of which are common obligations in investment treaties – are breached as

¹⁵⁰ Spain is currently being sued under one multilateral investment treaty, the Energy Charter Treaty, for actions relating to cuts in the incentives it had offered investors in order to promote development of renewable energy. Only limited information about the case is publicly available. See Investment Arbitration Reporter, Spain Round-UP: Twin Energy Charter Claims Moving at Different Speeds; Arbitrator in Third Case Agrees to Hear Jurisdictional Objections First (June 18, 2013).

a result of changes in incentives.¹⁵¹ While awards evaluating and judging the merits these claims have not yet been issued, the fact that they have been brought at all suggests that they are not legally frivolous. Even if not ultimately successful, the initiation of the cases alone can be costly for governments to defend, and may have a “chilling effect” on governments, making them reluctant to change unwise or costly incentives programs. Moreover, at least one case evaluating restrictions on performance requirements suggests that treaties may limit governments’ abilities to alter the incentives programs they had implemented in connection with imposing performance requirements aimed at maximizing the development impacts of foreign investment.¹⁵²

Investment treaties’ regulation of incentives

In addition to indirectly or directly driving use of incentives by facilitating increased capital mobility and potentially restricting changes in the relevant legal framework, investment treaties contain some provisions that can discipline their use. For one, most agreements contain non-discrimination obligations that prevent states from treating covered foreign investors less favorably than similarly situated domestic investors or investors from third states. These provisions could restrict the use of selective subsidies that favor one or some enterprises over others. While some have argued that discrimination must be on account of nationality in order to be prohibited, cases indicate that de facto and unintentional discrimination are also actionable.¹⁵³ A number of states – primarily developed countries with relatively elaborate treaties such as the US and Canada – have (1) specifically carved out subsidies and grants from the scope of these obligations, (2) safeguarded measures in force at the time of the treaty’s conclusion that might be inconsistent with the non-discrimination obligations, and/or (3) inserted policy-related exceptions, all of which can enable them to provide selective state supports. However, many states, mostly developed countries, have not included these narrowing provisions, and thus could be subject to claims by investors and the other state party or parties to the treaty that their subsidies are inconsistent with the investment treaties’ non-discrimination provisions.

Some agreements more directly restrict certain types of incentives, but provide only weak, if any, mechanisms to enforce those obligations. In particular, a growing minority of investment treaties include provisions stating that the contracting parties should not or must not reduce or fail to enforce environmental or labor standards in order to attract investment. These provisions aim to prevent countries from competing with each other for investment by reducing regulatory burdens on investors. The 2012 US Model Bilateral Investment Treaty (BIT), for instance, states:

The Parties recognize that it is inappropriate to encourage investment by weakening or reducing the protections afforded in domestic environmental laws. Accordingly, each Party shall ensure that it does not waive or otherwise derogate from or offer to waive or otherwise derogate from its environmental laws in a manner that weakens or reduces the protections afforded in those laws, or fail to effectively enforce those laws through a sustained or

¹⁵¹ Some treaties do have carve-outs for “taxation measures” which can mean that actions revising or removing fiscal incentives would not be actionable under the treaty.

¹⁵² *Mobil v. Canada*, ICSID Case No. ARB(AF)/07/4; see also Lise Johnson, *Mobil v. Canada – Ratcheting Down the Scope of Treaty Reservations*, UNCTAD Investment Policy Hub: Featured Discussion (Sept. 10, 2013).

¹⁵³ See, e.g., Lise Johnson, *Mobil v. Canada – Ratcheting Down the Scope of Treaty Reservations*, UNCTAD Investment Policy Hub: Featured Discussion (Sept. 10, 2013).

recurring course of action or inaction, as an encouragement for the establishment, acquisition, expansion, or retention of an investment in its territory.¹⁵⁴

The Parties recognize that it is inappropriate to encourage investment by weakening or reducing the protections afforded in domestic labor laws. Accordingly, each Party shall ensure that it does not waive or otherwise derogate from or offer to waive or otherwise derogate from its labor laws where the waiver or derogation would be inconsistent with the labor rights referred to in subparagraphs (a) through (e) of paragraph 3, or fail to effectively enforce its labor laws through a sustained or recurring course of action or inaction, as an encouragement for the establishment, acquisition, expansion, or retention of an investment in its territory.¹⁵⁵

The model states that these obligations apply not only to investments by those foreign investors covered by the treaty, *but to all investments within a host country's territory*.

In contrast to other provisions in investment treaties, however, there are limited or no mechanisms for enforcing these obligations. The 2012 US Model BIT, quoted above, only requires the states to consult with each other regarding issues arising under those articles,¹⁵⁶ and affirms that states may (but are not required to) “provide opportunities for public participation regarding” relevant matters.¹⁵⁷ The obligations regarding labor and the environment are neither subject to mechanisms for investor-state dispute settlement nor state-state dispute settlement.¹⁵⁸

Moreover, the types of “races to the bottom” targeted by these provisions are only a subset of the legal and regulatory races that can occur due to countries’ efforts to attract and retain mobile capital. States may, for instance, simply agree to pay investors for any additional costs they incur as a result of new environmental or labor legislation. They may also compete for capital by offering fiscal or financial incentives, or agreeing to provide land, infrastructure, or other resources on preferential terms. While not constituting offers to derogate from environmental or labor law, these incentives can erode states’ resources, transfer public resources to private entities, and have similarly detrimental impacts on societal welfare and policy objectives.

A third way in which investment treaties regulate the use of incentives is through their provisions on regulatory transparency. These may require all levels and branches of government to disclose any laws, regulations, procedures, rulings and decisions relating to investment, as well as any relevant laws, regulations, or procedures proposed for adoption.¹⁵⁹ These obligations thus can be used to mandate disclosure of programs and grants of investment incentives. Like the rules on non-derogation from environmental and labor standards, these regulatory transparency obligations can now be found in some relatively modern agreements, but are still only in the minority of the treaties that have been concluded and, where included, are often not subject to dispute settlement.

Finally, a fourth way investment treaties might address use of incentives is through incorporation of standards and guidance developed by the OECD and UN on the conduct of multinational

¹⁵⁴ 2012 US Model BIT, Art. 12(2) (internal footnote omitted).

¹⁵⁵ 2012 US Model BIT, Art. 13(2).

¹⁵⁶ 2012 US Model BIT, Arts. 12(6) & 13(4).

¹⁵⁷ 2012 US Model BIT, Arts. 12(7) & 13(5).

¹⁵⁸ 2012 US Model BIT, Arts. 24(1) & 37(5).

¹⁵⁹ See, e.g., 2012 US Model BIT, Arts. 10(1) & 11(2).

enterprises (see Box 10 below). There have been some efforts and calls to include in investment treaties obligations on firms to comply with such standards and guidelines. Noncompliance could then be relevant to a state's liability to an investor in the case of disputes regarding removal of or modifications to incentives, could give rise to claims or counterclaims, or could cause the investor to lose the benefits of the treaty.¹⁶⁰

The recently launched EU-US negotiations on a trade and investment treaty offer an opportunity to regulate more effectively on investment incentives. While the EU has rules restricting its member states' abilities to provide investment incentives, the US largely lacks similar regulations. It thus seems likely that European states would have concerns that a new investment liberalization and protection agreement would more fully expose them to efforts by the 50 US states and thousands of US municipalities to outbid European locations for new projects and use incentives to encourage European business to relocate operations. European states and the Commission might also be concerned as to whether orders for firms to repay subsidies would be deemed to breach treaty protections such as the obligation to provide fair and equitable treatment.¹⁶¹ Disciplines on the US use of incentives in such an agreement could, however, curb those cross-Atlantic battles.

Box 10: International Standards Regarding Firms' Activities Seeking and Obtaining Incentives

International instruments address the *role of businesses* in seeking and obtaining incentives. Two examples are the OECD's Guidelines for Multinational Enterprises (the "Guidelines")¹⁶² and the UN Principles for responsible contracts (the "Principles")¹⁶³.

The Guidelines are recommendations provided by governments to enterprises operating in or from adhering countries, which now number more than 40.¹⁶⁴ Though formally directed at *multinational enterprises*,¹⁶⁵ they also represent "good practice for all" and thus generally apply to foreign and domestic firms alike.¹⁶⁶

Relevant to the issue of incentives, the Guidelines state that enterprises should "[r]efrain from *seeking* or *accepting* exemptions not contemplated in the statutory or regulatory framework related

¹⁶⁰ SADC Model Bilateral Investment Treaty Template, with Commentary (Botswana: SADC, July 2012), p.55, available at: <http://www.iisd.org/itn/wp-content/uploads/2012/10/SADC-Model-BIT-Template-Final.pdf>.

¹⁶¹ As Luengo notes, in some cases the doctrine of "legitimate expectations" has been used to shield an aid beneficiary from the obligation to repay funds later deemed to have been provided in breach of the rules on State Aid. Investment treaties are often interpreted as incorporating a similar protection for "legitimate expectations" in their obligations to provide foreign investors "fair and equitable treatment." It is outside the scope of this paper to determine whether the two concepts are coextensive, but if the investment treaty standard were interpreted to be more protective of investors' rights than the EU standard, then repayment orders could conceivably breach an investment treaty.

¹⁶² OECD Guidelines for Multinational Enterprises (2011), available at: <http://www.oecd.org/daf/inv/mne/48004323.pdf>.

¹⁶³ Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie, Addendum, Principles for responsible contracts: integrating the management of human rights risks into State-investor contract negotiations: guidelines for negotiators, A/HRC/17/31/Add.3, May 25, 2011, available at: <http://www.ohchr.org/Documents/Issues/Business/A.HRC.17.31.Add.3.pdf>.

¹⁶⁴ OECD MNE Guidelines, Forward. Adhering countries include OECD members and non-members. More information is available here: <http://www.oecd.org/daf/inv/mne/>.

¹⁶⁵ OECD MNE Guidelines, I(1) (emphasis added).

¹⁶⁶ OECD MNE Guidelines, I(5).

to human rights, environmental, health, safety, labour, taxation, financial incentives, or other issues.”¹⁶⁷ Notably, the Guidelines not only recommends against requests for certain financial, fiscal, and regulatory incentives, but also discourages passive receipt of those benefits.

While the Guidelines disclaim that they are “voluntary and not legally enforceable,” adhering countries have made a binding commitment to implement them and have instituted mechanisms such as the system of National Contact Points in order to promote the Guidelines’ effectiveness.¹⁶⁸

The second instrument, the UN Principles for responsible contracting, which was developed under the mandate of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, provides recommendations to ensure that contracts between investors and states, including contracts containing incentive packages, are consistent with the state’s duty to protect human rights and the firm’s responsibility to respect them.

Principle 4 is relevant to the practice of granting regulatory incentives that provide investors with exemptions from or compensates them for changes in the generally applicable legal regime. The principle declares that states and investors should ensure that: [c]ontractual stabilization clauses, if used, [are] carefully drafted so that any protections for investors against future changes in law do not interfere with the State’s *bona fide* efforts to implement laws, regulations or policies in a non-discriminatory manner in order to meet its human rights obligations.¹⁶⁹ The Principles observe that stabilization clauses that could frustrate human rights include those freezing fiscal terms, as well as those restricting, or requiring compensation for, changes in laws relating to health, protection of the environment, labor and safety.¹⁷⁰

National and sub-national efforts to regulate competition for investment through use of incentives¹⁷¹

Examples abound of states, provinces, and municipalities competing to attract investment. Countries such as Australia, Brazil, Canada, China, India, Vietnam, and the US all have been noted for the costly bidding wars that have been conducted within their territories to attract new investment or pull investment from one part of the country to another. Some of these countries, or sub-national units within them, have consequently taken steps to govern such conduct, while in others the issue remains largely unregulated.

In **Canada**, poaching, or the use of incentives to cause an investment to move from one location to another, has driven action:

[P]oaching (usually called ‘piracy’ in the US) was a major problem in the 1990s, with Nova Scotia and Manitoba both losing existing call centers to New Brunswick, and Crown Life

¹⁶⁷ OECD MNE Guidelines, II(A)(5) (emphasis). The Guidelines also contain other relevant provisions, including those on transfer pricing. *Id.* at paras. 103-106.

¹⁶⁸ See OECD MNE Guidelines, Part II.

¹⁶⁹ Principles, at 2. See also Principles at 13.

¹⁷⁰ *Id.* at p. 13.

¹⁷¹ This section draws on the very useful research done by Kenneth Thomas presented in his book, *Investment Incentives and the Global Competition for Capital: Competing for Capital Revisited* (2013).

Insurance moving 1200 headquarters jobs from Toronto to Regina in 1991 with a C\$250 million provincial loan guarantee. It was in this context that the Code of Conduct on Incentives was agreed in July 1994 as part of the Agreement on Internal Trade (AIT), whose parties include the federal government, all 10 provinces, and two of the country's three territories. The Code (Annex 607.3) explicitly prohibited relocation subsidies in Article 3, Prohibited Incentives (Internal Trade Secretariat, 1994):

'No Party shall provide an incentive that is contingent, in law or in fact, and would directly result in an enterprise, located in the territory of any Party, relocating an existing operation into its territory.'

Moreover, under Article 4, Avoidance of Certain Incentives, the governments agreed to make 'best efforts' to avoid bidding wars; however, unlike Article 3, this was not legally binding.

That agreement remains in force but, according to Thomas, has had little effect: Only one complaint of poaching has been raised under the AIT, and that dispute was not resolved;¹⁷² poaching of investments from one province to another has continued, albeit on a smaller scale.¹⁷³

More recently, the two Canadian provinces of Alberta and British Columbia entered into the Labour Mobility Agreement which, since its entry into force in 2007, has broadly banned business subsidies provided by all levels of government in the two provinces.¹⁷⁴

Apart from these inter-provincial agreements, there has been increased regulation of competition by local government authorities, with eight of ten provinces prohibiting municipalities from granting incentives.¹⁷⁵

Thomas reports a similar story in **Australia**:

In Australia, bidding wars and poaching were also considered to be a problem for the states and territories. In 2000, South Australia offered auto parts firms A\$15,000 per job to relocate from Victoria. The following year, Victoria returned the favor by offering A\$2 million to South Australia parts maker Castalloy. Reform movements started as early as 1996, when the Community and Public Sector Union endorsed a New South Wales government initiative to end the poaching and bidding wars, and an Industry Commission report criticized state incentives and recommended that they be cut back or abolished entirely. The Industry Commission's successor, the Productivity Commission, published further estimates of state incentive spending in 2002. Following this, five of the country's six states (New South Wales, Victoria, Tasmania, South Australia, and Western Australia), plus

¹⁷² Thomas, K.P., 2011, *Investment Incentives and the Global Competition for Capital*. Palgrave Macmillan: USA, Ch. 8, at 21-22.

¹⁷³ Id.

¹⁷⁴ Id. at 24.

¹⁷⁵ Id. at 23.

the Northern Territory and the Australian Capital Territory (ACT), reached an agreement in 2003 to end bidding wars among them. In addition, the parties provide annual reports to each other on their investment attraction. Queensland was the only state that refused to go along. Stimulated in part by an A\$100 million subsidy to Fox News in Sydney, the signatories banned relocation incentives and pledged not to use subsidies for investments that were clearly coming to Australia. ...The three-year agreement was renewed for another five years in 2006.

The agreement was relatively weak in that it had no mechanisms for monitoring or enforcing the parties' commitments, did not include all states, and did not require publication of incentives, it nevertheless may have been effective. There were reports that implementation of the agreement helped reveal cases of businesses overstating offers of incentives from competing jurisdictions, resulted in a drop in the number of requests for relocation incentives, and saved the states millions of dollars.¹⁷⁶ When the agreement expired in 2011, however, it was not renewed.

In the US, the 50 states and the municipalities within them compete fiercely for investment. And, although some states have regulations requiring provision of investment incentives to be disclosed and/or restricting intra-state competition by municipalities, many do not.¹⁷⁷

At the federal level, the constitutional doctrine of the "dormant commerce clause" may restrict the use of some investment incentives.¹⁷⁸ Additionally, federal law prevents states and municipalities from using federal funds to poach investments from other locations. Overall, however, US law contains no comprehensive restrictions on inter-state or intra-state investment incentives.

Summary and trends regarding international, national and sub-national regulation of incentives

Table 15, below, compares different regulatory initiatives on the criteria of requirements, obligation of reporting and enforcement mechanisms. The text below the table provides additional points of comparison and cross-initiative analysis.

Table 15: Summarizing the initiatives of supranational/federal governance of incentives

¹⁷⁶ Thomas, K.P., 2011, *Investment Incentives and the Global Competition for Capital*. Palgrave Macmillan: USA., Ch. 8, at 26.

¹⁷⁷ See, e.g., Thomas, ch. 6, at 9-10.

¹⁷⁸ See, e.g., *Cuno v. DaimlerChrysler, Inc.*, 386 F.3d 738 (6th Cir. 2004), vacated in part due to lack of standing, 547 U.S. 332 (2006).

Initiative	Requirements	Mandatory reporting?	Enforcement
WTO SCM Agreement	Restricts use of specific subsidies relating to trade in good.	Yes	Enforcement is initiated by member states unilaterally or through a complaint procedure using the WTO's dispute settlement mechanisms
IAs	Relevant provisions in articles on non-discrimination, labor, environment, performance requirements, and transparency, but no general restrictions on state aids or investment incentives	No	Limited mechanisms are available to challenge actions to attract investment by lowering/not-enforcing environmental or labor standards in order to attract investment Some treaties permit subsidies/incentives to be challenged if discriminatory Rules on transparency requiring disclosure of incentives might be subject to state-state mechanisms
EU	Comprehensive rules restricting State aids that generally ban trade distorting investment incentives, but allows them for certain policy goals, including development of disadvantaged regions, support for research, development and innovation; employment and training; environmental	Yes	Commission plays a significant role in enforcement. There are repayment obligations for unlawful aid. Other interested natural and legal persons may also bring actions to challenge decisions approving or not approving aid.

	protection; energy conservation and development of renewable energy.		
Canada	<p>Provinces: Per Code of Conduct on Incentives, provinces barred from using relocation incentives; and must use “best efforts” not to engage in bidding wars. All ten provinces have agreed.</p> <p>Two provinces (Alberta and British Columbia) entered into a separate agreement banning business subsidies at all levels.</p> <p>Municipalities: eight of ten provinces prevent municipalities from granting incentives</p>	Yes (but reports not made public)	Code of Conduct Contains a complaint procedure. It has only been used once (in an anti-poaching claim filed by British Columbia in 1996). The dispute was never resolved and no other poaching case has since been raised.
Australia – Inter-state Cooperation Agreement (expired 2011)	Banned relocation incentives; states pledged not to use subsidies to attract investment already coming to Australia	Yes (but reports not made public)	Agreement did not contain any mechanisms for enforcement

Source: Drawn from Thomas (2012)¹⁷⁹

¹⁷⁹ Thomas, K.P., 2011, *Investment Incentives and the Global Competition for Capital*. Palgrave Macmillan: USA

- *Main objectives of different models:* The WTO's SCM Agreement focuses on restricting government measures that distort trade in goods between member states; the EU's rules on State aid are broader than those under the WTO in that they are not limited to measures impacting trade in goods, but also narrower in several ways, including that they only govern supports that constitute a charge on the public account and affect EU member states; IIAs generally prevent discriminatory subsidies on a broad multi-sectoral basis, and, in contrast to the EU's rules, may also restrict use of regulatory incentives even though such incentives do not necessarily require state resources or a charge on the public account. Sub-national rules regarding investment incentives entered into by states and provinces, to the extent they exist, seem to largely be centered on combating the specific issue of "poaching". Moreover, some agreements, such as the 1951 Paris Treaty and the WTO's Agreement on Agriculture are entirely sector specific, while others, such as the TFEU, allow some flexibility for sector-specific rules.
- *Policy Space:*
 - Regulation of subsidies and investment incentives generally targets only those measures that are specific or selective, allowing governments to retain freedom to establish legal and economic frameworks attractive to investments more generally, and to attract investment through efforts such as comprehensive infrastructure development and education and training.
 - International regulation of subsidies by the WTO and within the EU contains various carve-outs protecting even specific and trade-distorting subsidies where such subsidies are designed to correct market failures and advance legitimate policy goals such as promotion of development in low income states or areas of high unemployment, investment in R&D, and investment aiming at environmental protection. Subsidies used to advance such projects can incorporate such tools as monitoring and reporting requirements and penalties or claw-back requirements in order to ensure that the costs of the incentives produce result in the desired benefits.
- *Consideration for disadvantaged areas:* Some institutions, such as those established by the WTO and the EU's rules on State Aid contain special rules of application for states, and even regions within states, that are relatively disadvantaged, and thus might have (1) greater need to use incentives to attract investment, but (2) lesser resources to provide such incentives (particularly if they have to compete against incentives packages offered by wealthier jurisdictions).
- *Enforcement mechanisms:* The most effective rules and enforcement mechanisms, not surprisingly, are found in systems where there is some form of vertical hierarchy and an independent institution or body at or near the top of that hierarchy capable of assessing whether rules are being complied with and awarding compensation or assigning penalties for breach. The WTO's dispute settlement system plays this role;¹⁸⁰ and within the EU, the EU's Commission and ECJ serve these functions. The EU's system additionally allows private actors to initiate actions challenging violations of State aid rules. At the national level, a federal or central government can establish rules and sanctions with which provinces and states must comply while provinces and states, in turn, are able to set rules governing the conduct of the municipalities within their borders. Horizontal agreements and commitments

¹⁸⁰ With states also given unilateral rights of action via their power to impose countervailing duties.

are less effective unless, as is done in the context of investment treaties, an independent body has the power to determine compliance and determine remedies.

- *Transparency*: Instead of or addition to regulating the use of investment incentives, some efforts have been dedicated to promoting their transparency, requiring either ex ante notice (and approval) as in the case of the EU's State Aid rules, or ex post notification as in the case of the SCM Agreement.

Conclusion

The use of investment incentives is relevant to and impacts the most pressing issues facing us today, including tackling climate change; harnessing and leveraging the power of FDI for sustainable development; combatting unfair competition harmful to consumers; limiting corruption and rent-seeking that can drain resources and wealth from the public; managing costly competition among states for investment; aligning private and public interests on issues of environmental protection, human rights, and conditions of work; and designing the transparent and workable legal frameworks that can advance those aims in a manner that is equitable and ensures appropriate accountability.

This paper provides only a broad overview, illustrating current trends in state practice relating to incentives and the corresponding policy challenges. It also describes approaches explored to date for addressing those issues at the sub-national, national, and international level. Importantly, it highlights a key difficulty for addressing issues related to incentives for both researchers and policy makers: there is very little information—because of the lack of data collection and also the lack of transparency—related to the use of incentives in most jurisdictions around the world.

While current knowledge regarding the use of incentives is limited, this paper seeks to lay the foundation for renewed attention them. Collective action is required, as individual jurisdictions acting alone fear –often mistakenly – that they will lose out to competing jurisdictions if they curtail their use of incentives. As future steps, the paper identifies the following concrete areas for action:

- increasing the transparency of investment incentives;
- transitioning to a rule-based rather than ad hoc and discretionary system for granting incentives;
- building capacity and ensuring available resources for performing proper cost-benefit analyses and ensuring those analyses are systematically performed when making decisions; incentives should not dilute, eliminate or even outweigh the potential benefits of an investment project;
- ensuring incentives deals build in mechanisms for monitoring, oversight, and enforcement so that when incentives are granted, they actually advance the intended objectives;
- making sure that incentives, when used, are properly designed to meet the needs of their intended investor beneficiaries;
- designing systems that are simple and manageable for administrators and users alike;
- ensuring that, where used, incentives are consistent with and further development strategies;
- working cooperatively to restrict the use of public funds to “poach” an investment, drawing it from one location to another;

- developing cooperative strategies to prevent disadvantaged regions with limited resources from having to compete with wealthier regions that can easily outbid them in the quest for investment;
- preventing the excessive use of incentives such as certain stabilization clauses that create unduly inflexible legal and fiscal regimes and give rise to tensions between the interests of governments, firms, and citizens; and
- ensuring that there is policy coherence across disciplines and legal regimes.

Work is and has been proceeding on each of these issues in different fora at local, national and international levels. There are some examples of regulatory frameworks aiming to ensure that incentives are appropriately tailored to promote long-term, sustainable and inclusive growth; these could be both broadened and strengthened. Opportunities are also ripe to address these issues in the context of the ongoing global initiatives to strengthen governance of international economic activities, including on tax cooperation, business and human rights, climate change negotiations, and rules on investment promotion and protection.

Appendix

Appendix 1 - What is market failure?

A market failure is when the market does not lead to an economically efficient outcome. Externalities, imperfect information and coordination problems all lead to market failure.

Externalities: externalities occur when market players do not fully pay or benefit from the consequences of their actions on other actors in society: for instance in the case of polluting through industrial activity, market players may not have to pay for the full social cost of their actions (negative externalities) or in the case of research and innovation, market players may be deprived of the full benefits of their actions (positive externalities).

Public goods: goods that are beneficial for society but generally not provided by the market given that nobody should be excluded from their use. This can be the case of national defense, some types of public broadcasting, schools, and water infrastructure.

Imperfect information: leads to transaction costs, agency costs, and moral hazard, which in turn lead to inefficient market outcomes. This is often the case in regulation of the market by government agencies.

Coordination problems: occur for example in the field of standards setting, in transport infrastructure, or in the area of innovation.

Market power: such as monopoly and lack of competitive environment, which often drives up prices and limits supply.

High levels of **initial risk** with unknown benefits often lead to market failure. This is especially the case for R&D and innovation, public goods, or extractive industries. Arguments in favour of **infant industry** are often made from the above building blocks (imperfect capital markets, the 'appropriability' argument, or market power/scale arguments).

Dynamic market failures: current market prices might discourage businesses to invest in certain branches of production even with prospects of high and sustainable rates of profit in the future. However prices send the wrong signal because as investment proceeds and unit costs decline with increased output and external economies of scale, a country could acquire a comparative advantage in an expanding industry.

Source: Adapted from European Commission¹⁸¹ and UNCTAD (1995).

¹⁸¹ http://ec.europa.eu/competition/state_aid/reform/saap_en.pdf

Appendix 2 - ICA Investment deals database - Background, Industry classification and overview of the 50 states and their incentives

1- Background on the ICA database

The database collected by ICA is one core non-governmental source of information relating to investment incentives. The database uses publicly available reports by governments, companies and the media to capture the take-up of “incentive deals” by firms as well as incentive programs (policies) offered by governments. An incentive deal is a package of assistance offered either according to guidelines established for an existing incentive program, or through discretionary or ad hoc grants or fiscal incentives. The majority of incentive deals fall under the first category and are individually approved deals. Although they may come from a specific program with distinct guidelines, they are not ‘automatic benefits’ as with Free Trade Zones or Free Economic Zones. Rather, each company must apply to join the incentive program. In contrast, the second type of incentive -- discretionary or ad hoc incentives – are “non-program” incentives in that no investment incentive scheme was followed. In some cases, incentives might be provided pursuant to a program, but the link with the program will not be reported or disclosed. In Macedonia, for example, many large foreign investments have received incentive deals that fall within the national incentives framework, but the exact contents of the packages have been negotiated individually and have not been made public. Consequently, “non-specified” incentives deals will capture ad hoc or discretionary incentives, but may also include deals done in accordance with established government policies or programs.

Because of the overall global lack of transparency regarding some of these incentives programs, there are limitations on the type and comprehensiveness of data that can be collected. The ICA database thus is illustrative of trends and patterns, but does not represent a complete picture of governments’ practices regarding use of incentives. Pursuant to its methodology, the ICA database only includes:

- Incentive deals that are associated with greenfield investment, brownfield investment, and physical expansion, and which had direct job creation and direct job retention¹⁸².
- Incentive deals awarded to private domestic and foreign investors. Schools, public parks and community funding are not included.

¹⁸² Incentives associated with investments with Direct Job retention refers to government intervention through fiscal or financial incentives to help companies retain existing filled positions, which otherwise would be untenable and not competitive. Those incentives are typical of tough economic times where government usually provides incentives to employers to avoid layoffs - To record a deal in the US, the project must meet either one or both of the following two criteria;

- a) proof of job benefits (creation or retention)
- b) proof of capital investment used for a physical expansion

- For North America, an incentive deal if the incentive amounts are made public or can be calculated from other sources.

Among those incentives deals which are tracked and recorded, the database identifies and groups five types of incentives¹⁸³:

1. **Tax:** tax credits, tax rebates, tax abatements, tax increment financing, ad valorem tax, payment in lieu of taxes, Investment Tax Credit, Sales & Use tax credit/ abatement.
2. **Grants:** cash grants, training grants, subsidies
3. **Loans:** low-interest loans, forgivable loans, government guarantees, and equity.
4. **Not-specified:** incentive program details are not available or the deal is entirely discretionary.
5. **Non-financial:** Not incorporated yet into the data. This includes recruitment/relocation services, and fee waivers.

In addition to tracking the amount and type of incentive granted, ICA collects information relating to the potential benefits of the investment project. This includes data estimating the number of new jobs (companies are usually given a deadline by when they must create new jobs); safeguarded jobs (jobs that companies have pledged to retain as a result of the investment project); and capital expenditure (“capex” – i.e., the total investment being made by the investing company, which usually represents building and equipment costs, rent, and relocation costs). Estimates used for those figures on new and existing jobs, as well as capital expenditures, are generally based on projections provided by the relevant investing company.

2- Industry Classification used by ICA

Industry Sector	Definition
Aerospace, Defense & Marine	<p>Aerospace: advanced lightweight materials, aerodynamics, aeronautics, systems integration, wireless communications, all aspects of wing production including fuel flow, human interfaces, servicing, operation, flight efficiency, engine design/turbines</p> <p>Defense: (has overlap with aero & marine): armor, energetic substances, guided systems, propulsion, RF communications, sensors, signal processing, sonar, radar, autonomous vehicles, functional materials, modelling, electronics, power sources, biosensors</p> <p>Marine: (many from defense also): composite materials, fluid dynamics, surface coatings, communications, power systems.</p>

¹⁸³ The database does not include Bonds.

Automotive	Automobiles, Buses/coaches, Camper van/caravans, Light commercial vehicles (LCV), Multi-purpose vehicles (MPV), Passenger cars, Trucks, Sports utility vehicles (SUV). Auto electronics, Automotive components, Body/exterior parts, etc.
Basic Materials	Chemicals, industrial gases, Agrochemicals, Basic inorganic chemicals, Basic organic chemicals, Paints/coatings/sealants, Petrochemicals, Printing inks, Synthetic dyes/pigments Natural materials such as wood, stone, ceramic, glass etc.
Creative services	Advertising/Marketing/PR Facebook, Twitter, (Media companies NBC/ESPN) Films/TV Production (Business Function = RDD)
Consumer Goods	Packaging; windows+doors; Accessories Bicycles, Cosmetics/perfume, Cutlery/hand tools, DIY /home&garden store/products, Eyeglasses/spectacles/contact lenses, Household/office furniture, Jewelry/silverware/watches/clocks, Luxury goods, Office products/stationary, Other consumer products, Personal care products, Skin and Hair Care Products, Soap/Cleaning Products, Sports and leisure equipment, Toys/games/video/music/books, Household cleaning
Food and Drink	Soup/noodles, Petfood, Seasonings/sauces, Meat/poultry, Nutrition/health Oils, Other Agriculture/farming, Bread/bakery, Cocoa, Confectionary/sugar, Dairy, Fish, Frozen/prepared, Grains/pulses, Grocery store, Hypermarket, Fruit/vegetables, Water Soft drinks, Coffee/tea, Juice/fruit/vegetables, Milk, Not specified, Alcohol, vitamins, nutrition bars
Electronics;	ATM/cards Audio/Video Electronics Batteries Heating/cooling products/systems Home appliances Imaging Laser Lights/lighting/LED Liquid crystal display (LCD) Nanotechnology/MEMS Navigation/Satellite/Space Optical components Other electronic parts/components Picture Tubes Printed circuit boards (PCB) Solar/fuel cells Wires/cable Not specified
Industrial Goods	Industrial Machinery, Equipment & Tools Abrasive Products Agricultural machinery Automatic Vending Machines Boilers/Tanks/Vessels/Containers Chemical Industry Machinery Compressors/Hydraulic Equipment Construction Machinery Engines/Turbines Environmental Control Systems Food Product Machinery General Engineering Glass Working Machinery Handling Equipment Heating/Cooling Equipment Industrial Batteries Industrial Electrical Equipment Industrial Plant/Steelwork Machine Tools Measuring/Precision Instruments

	<p>Metalworking Machinery Mining/Oil/Gas Field Machinery Other Machinery/Goods Paper Industry Machinery Plastics/Rubber Industry Machinery Power Tools Printing/Packaging Machinery/Equipment Pump/Pipe Manufacturing Sawmill/Woodworking Machines Textiles Machinery Abrasive Products Agricultural Machinery Automatic Vending Machines Boilers/Tanks/Vessels/Containers Chemical Industry Machinery Compressors/Hydraulic Equipment Construction Machinery Environmental Control Systems Food Product Machinery Glass Working Machinery Handling Equipment Heating/Cooling Equipment Industrial Batteries Industrial Electrical Equipment Industrial Plant/Steelwork Machine Tools Measuring/Precision Instruments Metalworking Machinery Mining/Oil/Gas Field Machinery Other Machinery/Goods Paper Industry Machinery Plastics/Rubber Industry Machinery Power Tools Printing/Packaging Machinery/Equipment Pump/Pipe Manufacturing Sawmill/Woodworking Machines Textiles Machinery</p>
Info Technology and Telecommunications (ITT)	<p>Digital Media Enter App Soft (CRM)Enter App Soft (ERP)Enter App Soft (financial services)Enter App Soft (Industrial, Automation and Supply Chain)Enterprise Application Software Info Man Soft (Business Intelligence, Analytics)Info Man Soft (Collaboration and Knowledge Management)Info Man Soft (Content and Document Management)Info Man Soft (Data Management)Information Management Software IT Consultancy IT Outsourcing Mobile/Wireless NG Telecom Networks NG Telecom Services Soft Infra (Data Centre, Web Hosting)Soft Infra (Security)Soft Infra (Servers, Storage)</p>
Leisure + Tourism	<p>Amusement Parks/Arcades Casino/Gambling Conferencing Hospitality Services Hotel Media Museums/Arts Centers Restaurants/Cafes/Fast Food Sports/Recreation Centers Theatres/Entertainment Venues Tourism/Travel Services</p>
Life Sciences	<p>Anesthesia Cardiovascular, Central Nervous System, Clinical research, Endocrine Systems, Eye, Skin, Ear & Nose, Gastro-Intestinal Generics Immunological & Vaccines Infections Malignant Disease & Immunosuppression, Musculoskeletal, Nutrition & Blood Obstetrics/ Gynecology, Pharma ingredients, Pharmacies/Drug Stores Respiratory</p>
Non-renewable Energy	<p>Coal products, Petroleum products/lubricants, Electricity/gas utilities, Gasoline stations, Liquefied/compressed gas, Natural gas, Natural gas exploration</p>

Renewable Energy	Includes everything under the renewable energy umbrella from solar panels, photovoltaic cells etc. to biofuel; Alternative/Renewable fuels – EG: Biogas, Bio ethanol: bio diesel Nuclear Fuel Product Hydro, thermal, geothermal, wind power, bio diesel, bio ethanol, energy from waste recycling, steam power; ethanol; <i>nuclear technology</i>
Services	Business process outsourcing (BPO) Car rental, Consultancy Document, management, Education/training, Legal/accountancy, Market research/publishing/news, Other services, Recruitment, Schools/universities

3- Tables: Total value of incentives and comparison with GDP per capita

Table 16: Disparities between States in terms of total value of incentives for the period January 2010 – October 2013

State	Total (US\$M) -
California	9341
Michigan	4769
Louisiana	3768
Arizona	2834
Tennessee	2401
Pennsylvania	2083
Ohio	2032
Idaho	2020
New Jersey	1972
Nevada	1247
Kentucky	1189
Connecticut	1050
New York	1039
Indiana	1012
Colorado	849
Mississippi	825
Illinois	810
Oregon	804
North Carolina	788
Missouri	745
Alabama	736
Iowa	721
Florida	706
Texas	667
Wisconsin	641
South Carolina	612
Georgia	581
Oklahoma	563
Massachusetts	442
Kansas	438
Utah	397
Minnesota	384
Maryland	228
West Virginia	196
Arkansas	177
Virginia	150

Maine	140
New Hampshire	140
Hawaii	117
Delaware	104
Rhode Island	88
Washington	62
South Dakota	48
Vermont	48
Nebraska	46
Alaska	45
District of Columbia	39
Montana	25
New Mexico	22
North Dakota	15
Wyoming	15
Total	50180

Source: www.ICAINcentives.com by Investment Consulting Associates (ICA) -2013

Table 17: GDP per Capita (2013)¹⁸⁴ and Total Amount of Incentives per States (2011- 2013)

State	Rank in terms of value of incentive	Total (US\$M) In incentives granted	GDP Rank	GDP per capita (\$)
Alabama	21	737	46	36,333
Alaska	45	45	3	65,143
Arizona	4	2834	39	40,828
Arkansas	34	177	45	36,483
California	1	9341	13	51,914
Colorado	15	850	12	51,940
Connecticut	12	1050	4	64,833
Delaware	39	104	2	69,667
District of Columbia	46	39	1	174,500
Florida	22	706	40	40,106
Georgia	26	582	35	41,711
Hawaii	38	117	19	49,214
Idaho	8	2020	50	34,250
Illinois	17	810	16	50,328
Indiana	14	1012	36	41,169
Iowa	22	721	20	49,067
Kansas	29	438	28	44,310
Kentucky	11	1189	43	37,535
Louisiana	3	3768	22	47,467
Maine	36	140	38	40,923
Maryland	32	228	14	51,724

¹⁸⁴ http://www.usgovernmentrevenue.com/compare_state_revenue_2013dZ0g

Massachusetts	28	442	6	58,108
Michigan	2	4769	42	37,616
Minnesota	31	384	15	50,396
Mississippi	16	825	51	32,967
Missouri	20	746	37	41,117
Montana	47	25	44	37,200
Nebraska	44	46	18	49,778
Nevada	10	1248	24	47,222
New Hampshire	37	140	23	47,385
New Jersey	9	1972	9	56,477
New Mexico	48	22	47	35,952
New York	13	1040	8	57,423
North Carolina	19	788	31	42,884
North Dakota	49	15	21	47,714
Ohio	7	2032	33	42,035
Oklahoma	27	563	32	42,237
Oregon	18	804	27	44,447
Pennsylvania	6	2083	25	45,323
Rhode Island	40	88	26	45,000
South Carolina	25	612	48	35,717
South Dakota	42	48	17	49,875
Tennessee	5	2401	41	39,730
Texas	23	668	7	58,099
Utah	30	398	34	41,750
Vermont	43	48	30	44,000
Virginia	35	150	10	53,463
Washington	41	62	11	52,403
West Virginia	33	196	49	35,053
Wisconsin	24	642	29	44,105
Wyoming	50	15	5	63,667

Source: www.ICAincentives.com by Investment Consulting Associates (ICA) -2013

Appendix 3 - Incentives in Asia – Asia Development Bank– Database

Table 18: Incentives in Asia

	<u>Bangladesh</u>	<u>Bhutan</u>	<u>Cambodia</u>
Standard CIT Rate	Publicly traded company 27.5%	30% of net profit	20%
Dividend Withholding Taxes	15%, For foreign investment, it is based on existence of a bilateral tax	10%	Taxed at relevant CIT rate; creditable against CIT Non-taxation on the distribution of dividends, profits or proceeds of investments, whether transferred abroad or distributed within the country
Sectors Qualifying for Incentives (not exhaustive)	Exporters	Manufacturing, service industries, financial institutions, agriculture, information and communications, tourism, film and media, construction, transport, education, health	Pioneer and/or high technology industries, job creation, export-oriented, tourism industry, agro-industry and transformation industry, physical infrastructure and energy, provincial and rural development, environmental protection and, investments in Special Promotion Zone (SPZ)
Tax Holidays	In Dhaka and Chittagong Divisions: 100% in first 2 years; 50% in succeeding 2 years; and 25% in the 5 th year In Dhaka and Chittagong Divisions: 100% in first 2 years; 50% in succeeding 2 years; and 25% in the 5 th year	Existing businesses established on or after 1 July 2007 shall be given applicable tax holiday to take effect 1 January 2010 for the remaining period <i>See Bhutan TaxHolidayTable.doc</i>	Maximum of 8 years
Reduced CIT Rates	Any listed company declares dividend at 20%, or higher, will benefit from tax abatement at 10%	Income tax exemption on export earnings in convertible currency of business enterprises (other than	9% after end of holiday for favored projects

		<p>tourism)</p> <p>Reinvestments shall be allowed as tax deductible expenses up to a maximum of 25% of total reinvestment</p> <p>Expenditure incurred for R&D shall be allowed as tax deductible expenditure</p> <p>Grant made by an entity for R&D shall be allowed tax deductible expenditure</p> <p><i>See Bhutan TaxHolidayTable.doc</i></p>	
Investment allowances and credits	<p>90% loans against letters of credit and funds for export promotion</p> <p>Domestic market sales of up to 20% is allowed to export oriented business located outside and export processing zone on payment of relevant duties</p> <p>Cash incentives and export subsidies guaranteed on free on board value of selected exports ranging from 5% to 20% on selected products</p>	<p>Business with environmentally-friendly technological upgrade beyond the minimum standard requirement shall be allowed income tax rebate of 15%</p>	N/A
Accelerated Depreciation	<p>Available for new industries: 50%, 30%, 20% for the first, second, and third years respectively (on cost of plant and machinery)</p>	<p>Reinvestment allowance of 25 percent shall be allowed to be claimed as deductible expenditure in the year following completion of qualifying project</p> <p>Infrastructure facilities- 3, 20% and 50-</p>	<p>Immediate expensing of plant and equipment investment financed from reinvested profit</p>

DO NOT CIRCULATE

		<p>100% on selected items</p> <p>Electricity generation and transmission- 5%</p> <p>Equipment, furniture, fixtures and utensils, plant and machinery, vehicles, vessels and aircrafts- 15%</p>	
Import duty and VAT exemptions	Businesses exporting 80% or more of goods or services enjoy duty free import of machinery and spares, bonded warehousing	<p>Sale tax and customs duty exemption for: manufacturing service industries for import of plant and machinery; raw materials and primary packaging materials; financial institutions' procurement of software and hardware for credit/debit card; electric cars/hybrid cars including spare parts and cars that run on renewable energy; equipment and labor-saving devices purchased by individual artisans and craftsmen in rural areas; import of plant and machinery for waste management/recycling activities; farm machinery and other related agricultural inputs; computers related hardware and software for IT sector; imported construction materials forming direct inputs for IT park development; import of buses by tour operators; equipment for camping, trekking, rafting, kayaking, boating and such other equipment for 10 years; import of furniture and fixtures for tourist-class hotels; specific professional equipment required by entities in the media and animation film</p>	Exemption of import duty on construction materials and equipment (0-35%)

		industry; heavy machinery, earth-moving and drilling equipment, tippers and dumpers imported by contractors and hiring companies; green building materials; buses used by passenger transport entities; import of school buses, foreign published text books, journals, periodicals, teaching aid materials, library books, furniture and fixtures for classrooms and auditoriums; green building materials and special materials for construction of educational facilities	
Export processing zones	<p>Enjoy 10 year tax holiday Concessionary tax for 5 years, after the first 10</p> <p>Duty and tax free exports from the zone</p> <p>Intra and inter zone exporting and sub-contracting</p> <p>Fully serviced plots</p> <p>Ready-made factory buildings</p> <p>Available infrastructure facilities</p> <p>Warehouses and bonded areas</p> <p>Duty free import of machinery, raw materials, construction materials and spare parts</p>	N/A	Export-oriented projects located in Special Promotion Zone enjoy 100% import duties exemption on construction materials, means of production, equipment, intermediate goods, raw materials and spare parts

	<p>Sale of 10% finished product to domestic tariff area Sale of 10% surplus raw material to domestic tariff area</p> <p>Sale of 10% defective finished goods and domestic tariff area items</p> <p>100% backward linkage and accessories items are allowed to sale in export oriented industries (deem export)</p> <p>Sale of old/scrap machineries in domestic market</p> <p>Business and administration support services</p> <p>Customs clearances on site</p> <p>Recreational amenities</p>		
Others	<p>Remittance of royalty, technical know-how and technical assistance fees</p> <p>Repatriation facilities of dividend and capital at exit</p> <p>Permanent resident permits on investing US\$75,000 and citizenship on investing US\$75,000</p>		<p>Foreign and domestic investors enjoy the same rights of National Treatment. Hence, all foreign investors can invest in all sectors of the Cambodian economy including in the industrial sector, services sector as well as natural resources sector. There is however one restriction: land ownership, although the ownership of land is reserved to natural and legal Cambodian persons, natural and legal foreign persons have the possibility to</p>

	Export guarantee scheme		use land through lease contracts for a period up to 99 years Losses carried forward for up to five years
Sources	Board of Investment - http://www.boi.gov.bd/about-bangladesh/why-bangladesh/fiscal-and-non-fiscal-incentives	Ministry of Finance – http://www.mof.gov.bt/downloads/fiscalIncentivesApril2010.pdf	Invest in Cambodia - http://www.investincambodia.com/INVESTMENT%20INFORMATION.pdf The Cambodia Chamber of Commerce - http://www.ccc.org.kh/index.php?option=com_content&view=article&id=93&Itemid=99 Council for the Development of Cambodia - http://www.cdc-crdb.gov.kh/

	<u>Hong Kong, China</u>	<u>India</u>	<u>Indonesia</u>
Standard CIT Rate	16.5%	30% with surcharge of 10% if taxable income exceeds	Progressive rates (10%-30%)
Dividend Withholding Taxes	No dividends tax	20% tax for non-treaty foreign companies; 15% tax for US companies under treaty	15 percent: residents, 10-20 percent; non-residents 50 percent reduction in favored sectors/zones
Sectors Qualifying for Incentives (not exhaustive)	Exporters	Agriculture, mining, manufacturing, power, and services (health and medical, tourism, business process outsourcing IT enabled services, research and development, etc.)	Exporters, hard-crop plantations, mining, businesses in remote areas
Tax Holidays	No tax holiday because of low rate. But if a company has only done offshore business, it can apply for 0% tax rate	5 year tax holiday for: power projects, firms engaged in exports, new industries in notified states and for new industrial units established in electronic	3-8 year income tax holidays for new enterprise in 22 specific sectors

DO NOT CIRCULATE

		hardware/software parks, 1994-1995 budget firms engaged in providing infrastructure facilities	
Reduced CIT Rates	None. Lowest is 16.5%	Tax deductions of up to 100% of export profits 30% deduction of net (total) income for 10 years for new industrial undertakings 50% on foreign exchange earnings by construction companies, hotels and on royalty, commission, etc.	Taxable income reduction as much as 30% of the realized investment spread in 6 (six) years
Investment allowances and credits	Provision of support services through various programs and activities Immediate writing off for capital expenditure on plant and machinery Capital expenditure on refurbishment of business premises allowed to be written off over 5 years of assessment Tax concessions for gains derived from qualified debt instruments Concessionary tax rate for offshore business of reinsurance companies Exemption from tax on interest on deposit placed in Hong Kong Exemption from tax for offshore funds with regards profit from transactions in securities, futures contracts, forex etc.	N/A	Five percent per year of net income for six years (reduction of net income/investment allowance) Loss carried forward facility for period of no more than 10 (ten) years

Accelerated Depreciation	<p>Accelerated deduction for capital expenditure on specified environmental protection facilities</p> <p>Industrial buildings allowances: initial allowance 20% on construction cost; annual allowance 4%</p> <p>Commercial buildings allowances: annual allowance 4 percent</p> <p>Plant and machinery: initial allowance 60% on cost, annual allowance rate of 10%, 20%, or 30% on the reducing value of asset</p>	<p>20% for buildings</p> <p>100% for purely temporary structures</p> <p>25% for machinery and equipment</p> <p>100% for specified energy-saving/renewable energy devices, specified machinery used in mines and quarries, mineral oil concerns, salt and sugar works, iron and steel industries, glassworks, etc.</p> <p>10% for furniture and fittings</p> <p>15% special furniture and fittings used in hotels, cinemas, etc.</p>	<p>Depreciation is based on declining balance method:</p> <p>For non-building- 100 percent for group 1, 50 percent for group 2, 25 percent for group 3, and 20 percent for group 4</p> <p>For building- none</p>
Import duty and VAT exemptions	<p>No sales tax or VAT on imports or exports</p> <p>Full tax deduction on expenditure on plant and machine related to manufacturing and on computer hardware and software</p>	<p>Exempted from customs duty: selected raw materials and equipment imported by manufacturer-exporters of sports goods, leather goods, textile products and footwear industry, unworked corals, water sports equipment</p>	<p>Relief from import duty so that the final tariffs become 0 percent</p>
Export processing zones	<p>Support for incubation programs to nurture technology start-ups, providing premises and services in the Science Park for applied R&D activities</p>	<p>Complete tax holiday for industrial units in Free Trade Zones</p>	<p>Industrial companies located in the bonded areas:</p> <p>Exemption from import duty, excise, income tax, value Added Tax on Luxury Goods on the importation of capital goods and equipment including raw materials for the production process;</p> <p>Allowed to divert their products</p>

			<p>amounted to 50 percent of their export for the final products, and 100 percent of their exports (in terms of value) for other than final products to the Indonesian customs area, through normal import procedure including payment of customs duties;</p> <p>Allowed to sell scrap or waste to Indonesian custom area as long as it contains at the highest tolerance of 5 percent of the amount of the material used in the production process; and</p> <p>Allowed to lend their own machineries and equipments to their subcontractors located outside bonded zones for no longer than 2 (two) years in order to further process their own products</p>
Others	Various SME funding schemes to secure financing for acquiring business installations and equipment.	FDI up to 100 percent under the Automatic route is allowed in the following sectors: manufacturing, infrastructure, service (data processing, software development and computer consultancy services; Software supply services; Business and management consultancy services, market research Services, technical testing & analysis services)	
Sources	Trade and Industry Department - http://www.tid.gov.hk/cindex.html Inland Revenue Department - http://www.ird.gov.hk/eng/pdf/tax_g	India Finance and Investment Guide - http://finance.indiamart.com/taxation/tax_rebates/index.html Ministry of Commerce and Industry,	Directorate General of Taxes of Republic of Indonesia - http://www.pajak.go.id/eng/index.php?view=article&catid=100%3Apph&id=155%3Asubjek-

	uide_e.pdf The Government of Hong Kong Special Administrative Region - http://www.investhk.gov.hk/default_bodies/whyhk/en_tax.html	Department of Industrial Policy and Promotion - http://dgftcom.nic.in/exim/2000/policy/hbppol1/2009-2010/contents.htm ; http://dipp.nic.in/	pph&option=com_content&Itemid=171&limitstart=5 Indonesia Investment Coordinating Board - http://www.bkpm.go.id/
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	Republic of Korea	Lao PDR	Malaysia
Standard CIT Rate	Company earning 100 million won and less – 13% Over 100 million won- 13,000,000 won plus 25 percent of excess of 100,000,000 won	26%	28%
Dividend Withholding Taxes	Company earning 100 million won and less- 13% Over 100 million won 25%	10% dividend withholding tax	Dividends paid out of tax-exempt income to shareholders will also be exempted from tax (for Approved Services Projects and Investment Allowance)
Sectors Qualifying for Incentives (not exhaustive)	Industrial supporting services, high tech implementation, manufacturing, tourism, logistics, R&D, medical institution	Promoted activities: production for export; agricultural and forestry activities; industrial processing and other industrial activities; human resources development; infrastructure construction; production of raw materials and equipment; and tourism and transit services	Corporations in manufacturing, agriculture, tourism and various other activities may receive 'pioneer status'
Tax Holidays	5-7 years First 5 years 100% tax reduction, additional 2 years 50% tax reduction	For Zone 1 (mountainous, plain and plateau zones with no economic infrastructure to facilitate investments): Profit tax exemption for 7 years and 10% for succeeding years For Zone 2 (mountainous, plain and	5 year tax holiday on 70 to 100 percent of statutory income (10 years for companies of national/strategic importance)

DO NOT CIRCULATE

		<p>plateau zones with certain level of economic infrastructure suitable to accommodate investments to some extent): Profit tax exemption for 5 years and 7.5% for three years and thereafter 15%</p> <p>For Zone 3 (mountainous, plain and plateau zones with good infrastructure to support investments): profit tax exemption for 2 years, 10% for the next 2 years and 20% thereafter</p>	
Reduced CIT Rates	<p>General cases: foreign investor capital subject for reduction/total capital x reduction rate of the business year (100%, 50%)</p>	<p>Please refer to provisions in tax holiday section</p> <p>During tax exemption period and tax reduction period, enterprise is entitled to exemption of minimum tax. Profit used for expansion of licensed business activities will be exempt from profit tax</p>	<p>Offshore companies in Labuan can elect to: pay tax at a rate of 3 percent of net profit, or pay RM 20,000</p> <p>Income of offshore companies from non-profit trading activities is not subject to any taxes</p>
Investment allowances and credits	<p>Cash grant to fund new factories- cash grant ratio shall be determined at 5% and higher of the FDI</p> <p>Government assistance of up to 50% of foreign investment or up to 25% of surplus profits</p> <p>Financial support for:</p> <ol style="list-style-type: none"> 1. Site location (land purchase or rent) 2. Land subsidy 3. Rent subsidy 	N/A	<p>Allowance of 60 percent on qualifying capital expenditure incurred within 5 years</p> <p>Companies located in Sabah, Sarawak, the Federal Territory of Labuan and designated eastern corridor of Peninsular Malaysia enjoy an allowance of 80 percent on qualifying capital expenditure incurred within 5 years</p> <p>High technology companies: allowance of 100 percent on qualifying capital</p>

	<p>4. Training subsidy</p> <p>5. Employment subsidy</p>		<p>expenditure incurred within 5 years</p> <p>R&D companies: allowance of 100 percent on qualifying capital expenditure incurred within 10 years</p> <p>In-house R&D: allowance of 50 percent on qualifying capital expenditure incurred within 10 years</p> <p>Technical or vocational training company: allowance of 100 percent on qualifying capital expenditure incurred within 10 years</p> <p>Industrial Adjustment allowance- allowance of 60 percent - 100 percent based on industrial adjustment activities undertaken. Will be given to qualifying capital expenditure incurred within 5 years</p> <p>Infrastructure allowance - allowance of 100 percent on qualifying capital expenditure</p>
Accelerated Depreciation	Accelerated depreciation of capital goods enjoy tax exclusion upon filing necessary documents.	N/A	<p>Computer and information technology assets including software - initial allowance of 20 percent and annual allowance of 40 percent</p> <p>Environmental protection equipment - initial allowance of 40 percent and annual allowance of 20 percent</p>

			<p>Companies that reinvest in production of promoted products and food items are eligible for accelerated capital allowance upon expiry of reinvestment allowance - initial allowance of 40 percent and annual allowance of 20 percent</p> <p>Deduction for acquiring property rights - capital expenditure on acquiring proprietary rights such as patent, industrial design/trademark is allowed a deduction of 20 percent on cost of acquisition of proprietary rights for 5 years.</p>
Import duty and VAT exemptions	<p>Exemptions on import of tax exempted goods, tax exemptions according to the purpose of taxed objects</p> <p>Capital goods financed by foreign or local funds enjoy exemptions from duty, special excise tax and VAT</p> <p>Zero-tax rate on: exported goods, services provided abroad, overseas transport services by ships & plans, other foreign currency acquiring goods & services</p> <p>Tax exemptions: basic daily necessities and services for the general population, goods and services for national health, culture-related goods and services, manufacturing related goods and</p>	<p>Exemption of import duties and taxes on equipment, spare parts, vehicles used for productions, raw materials, semi finished products imported for manufacturing or for processing for the purpose of export</p> <p>Exemption of export duty on exports</p> <p>Raw materials and semi finished products imported for manufacturing or assembly for import substitution will be exempted from import duties and taxes or will be subject to reduced rates of import duties and taxes</p> <p>Duty of only 1% for imports of capital equipment, spare parts, and other means of production</p>	<p>International Procurement Center- exemption of import duties on raw materials, components and finished products</p> <p>Import duty exemption on raw materials/components (production for export and domestic market- full import duty exemption on imported direct raw materials not available locally)</p> <p>Import duty, sales tax and excise duty exemption on machinery and equipment with full exemption on: import duty and sales tax for imported machinery/equipment not available locally; and sales tax and excise duties on locally purchase machinery/equipment</p>

	<p>services, work-like human services: human services, import of tax exempted goods, and tax exemptions according to the purpose of taxed objects</p>		<p>Duty exemption on spares and consumables w/ the ff conditions: company must export at least 80% of production, spares and consumables have limited demand & do not have potential for domestic production, and import duty on such items exceeds 5 percent</p> <p>Duty drawback: manufacturers who paid import duty on raw materials & components and used it to produce goods for export w/in a year are eligible to claim drawback</p> <p>*Make Separate Table*</p>
Export processing zones	<p>Designated business in foreign invested zone, enterprise in free trade zone, foreign invested company in free trade zone and Jeju Investment Promotion Zone enjoy tax reduction of 100 percent for 3or 5 years and 50% for the next 2 years.</p> <p>Other incentives:</p> <ol style="list-style-type: none"> 1. Tax abatement 2. Customs tariff exemption 3. VAT exemption 4. Rent reduction 	<p>Special economic zones, industrial zones, border trade areas and other specific economic zones shall follow law and regulations of such specific areas</p>	
Others	<p>National/public property lease and rent reduction-100 percent reduction for foreign invested companies in stand-alone type foreign investment areas, 75 percent reduction for manufacturing</p>	<p>Permission to own all improvements and structures on the leased land, transfer leases to other entities, and permission to sell or remove improvements or structures</p>	

DO NOT CIRCULATE

	businesses of 5 million USD and over in complex-type foreign investment areas, 50 percent reduction for land within national industrial complex, local industrial complex, urban hi-tech industrial complex and agricultural complex		
Sources	Invest Korea - http://www.investkorea.org	Department of Domestic and Foreign Investment - http://www.invest.laopdr.org/	

Tax Holidays	Bhutan
Cottage and Small Industries (CSI) and cooperatives	10 year income tax holiday for outside Thimphu and Phuentsholing city areas
	Additional 10 year tax holiday established in remote areas
Waste Management and Recycling Industry	15 years income tax holiday
Agriculture Sector	10 years and additional 5 years for commercial farming of organic produces
Information and communication technology	15 years for an IT park developer; 10 years to be the IT/IT Enabled Service businesses located outside IT park
Tourism Sector	10 years for newly established high-end hotels
Film and Media Sector	10 years tax holiday; exemption from income tax for 5 years on income earned from production of films, documentaries and serials by local media firms for public broadcasting; 5 year income tax holiday for media service providers, viz., print media and broadcasting entities
Transport Sector	5 years tax holiday for taxi/car hire service companies

Education Sector	15 years
Health Sector	5 years for newly established high-end private health services

Reduced CIT Rates	Bhutan
Cottage and Small Industries (CSI) and cooperatives:	Income tax exemption on interest income earned by financial institutions through lending to the CSIs and cooperatives
	Tourism: Income Tax Act will be reviewed to allow entertainment expenses up to 5 percent of the assessed net profit; income tax exemption for farm houses used as hospitality units located in rural areas

Appendix 4 – Review of Case Studies of EU Regional Aid

Table 19: Investment Determinants, Aid Intensities in EU Case Studies on Regional Aid 2007-2013

	Aid amount	Aid intensity	Level of regional aid compared to RAG ceiling	Investment drivers	Incentive effect for invest. decision	Location drivers	Incentive effect on location decision
Pharmaceutical industry (Ireland)	Low	Low	Lower than ceiling	Rising demand, availability of new technologies, efficiency-seeking	Low	Pre-existing operations on site, availability of skilled labour force, presence of leading cluster	Low
Solar industry (Germany)	High	Medium	At ceiling	Rising demand, availability of new technologies, high profit margins, efficiency seeking	Low/ Medium	Pre-existing operations and availability of land at the site, skilled labour force and proximity to ancillary industries (cluster)	Medium
Automotive industry (Slovakia and Hungary)	High	Medium	Close to ceiling	Need to adapt to evolving demand and create new production lines for new products, efficiency seeking	Low/ Medium	Low labour costs, quality of the labour force, availability of transport infrastructure	Medium
Internal business services (Poland)	Very low	Low	Lower than ceiling	Efficiency-seeking through cost reduction, increased capacities and enhanced quality of services	Low	Low labour costs, quantitative and qualitative availability of labour force	Low
Cement industry (Hungary)	Medium	Medium	Lower than ceiling	Rising demand, efficiency-seeking	Low	Availability of raw material, geographic proximity to and accessibility of local markets	Low
Pulp and paper industry (Spain and Portugal)	Medium	Medium	Close to ceiling	Rising demand, need to increase efficiency to adapt to increasing competition	Medium	Pre-existing operations on site, transport infrastructure and accessibility, availability of a skilled labour force and of raw material	Low

Source: Ex-Post Evaluation of the Regional Aid Guidelines 2007-2013, at 154.

Table 20: Impacts of the Investments in Terms of Regional and Employment Benefits and Externalities in EU Case Studies on Regional Aid 2007-2013

	Job creation	Jobs safe-guarded	Quality of jobs	Indirect jobs	Impact on R&D	Spill-over effect	Follow on investments	Cluster-specific impacts
Pharmaceutical industry (Ireland)	Low	Medium	High	Low	High	High	No	Yes
Solar industry (Germany)	High	Low	High	Medium	High	Medium/High	n/a	Yes
Automotive industry (Slovakia and Hungary)	High	Low	Low	High	Low	Low	No	No
Internal business services (Poland)	Medium	Low	Medium	Low	Low	Medium	Yes	No
Cement industry (Hungary)	Low	Low	Low	Medium	Low	Low	No	No
Pulp and paper industry (Spain and Portugal)	Low	High	Low/ Medium	High	Medium	Medium	No	Yes

Source: Ex Post Evaluation of the Regional Aid Guidelines 2007-2013, at 160.