Incentives – The Good, the Bad and the Ugly

Vale Columbia Center International Investment Conference

New York, Nov 13-14, 2013

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Investment Climate Advisory Services of the World Bank Group

IFC International Finance Corporation World Bank Group

MIGA World Bank Group Multilateral Investment Guarantee Agency

THE WORLD BANK

Prevalence of Tax Incentives around the World

	Number of Countries Surveyed	Tax holiday/ Tax exemption	Reduced Tax rate	Investment allowance/Tax credit	VAT exemption/ reduction	R&D Tax Incentive	Super-deductions	SEZ/ Free Zones/ EPZ/ Freeport	Discretionary process
East Asia and Pacific	12	92%	92%	75%	75%	83%	8%	83%	25%
Eastern Europe and Central Asia	16	75%	31%	19%	94%	31%	0%	94%	38%
Latin America and the Caribbean	24	75%	29%	46%	58%	13%	4%	75%	29%
Middlea East and North Africa	15	73%	40%	13%	60%	0%	0%	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	60%	63%	73%	73%	10%	23%	57%	47%

Tax Incentives in one form or the other are prevalent in all regions of the World

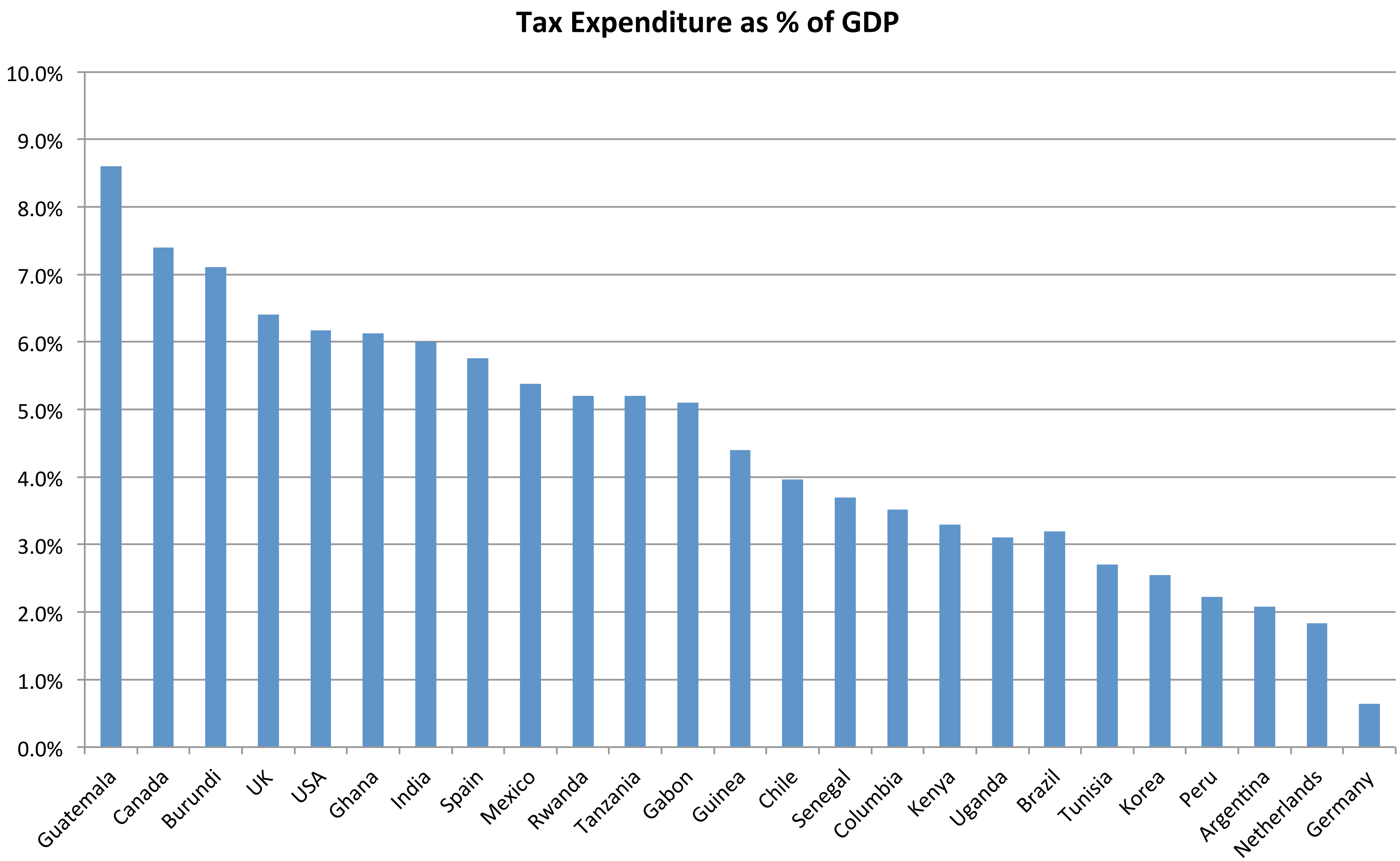
Incentives Framework

The Benefits and Costs of an Incentive Policy

Revenue rise due to increased investment	+	Social benefits from increased investment	>	Lost revenue from investments that would have been made anyway	+	Indirect cost of incentives

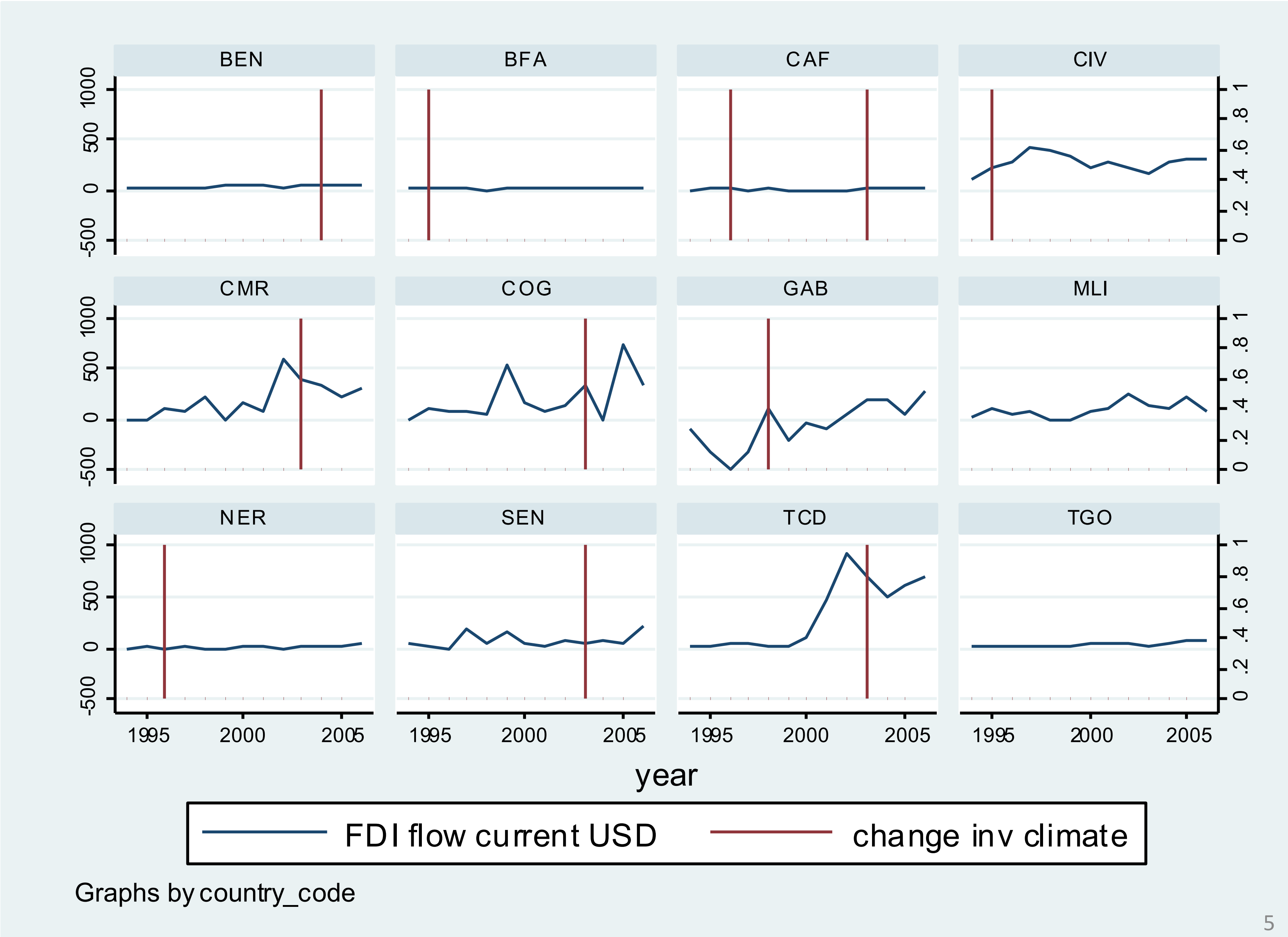
Social Benefits include cleaner environment, better skills, better health, etc.

Tax Expenditures around the world



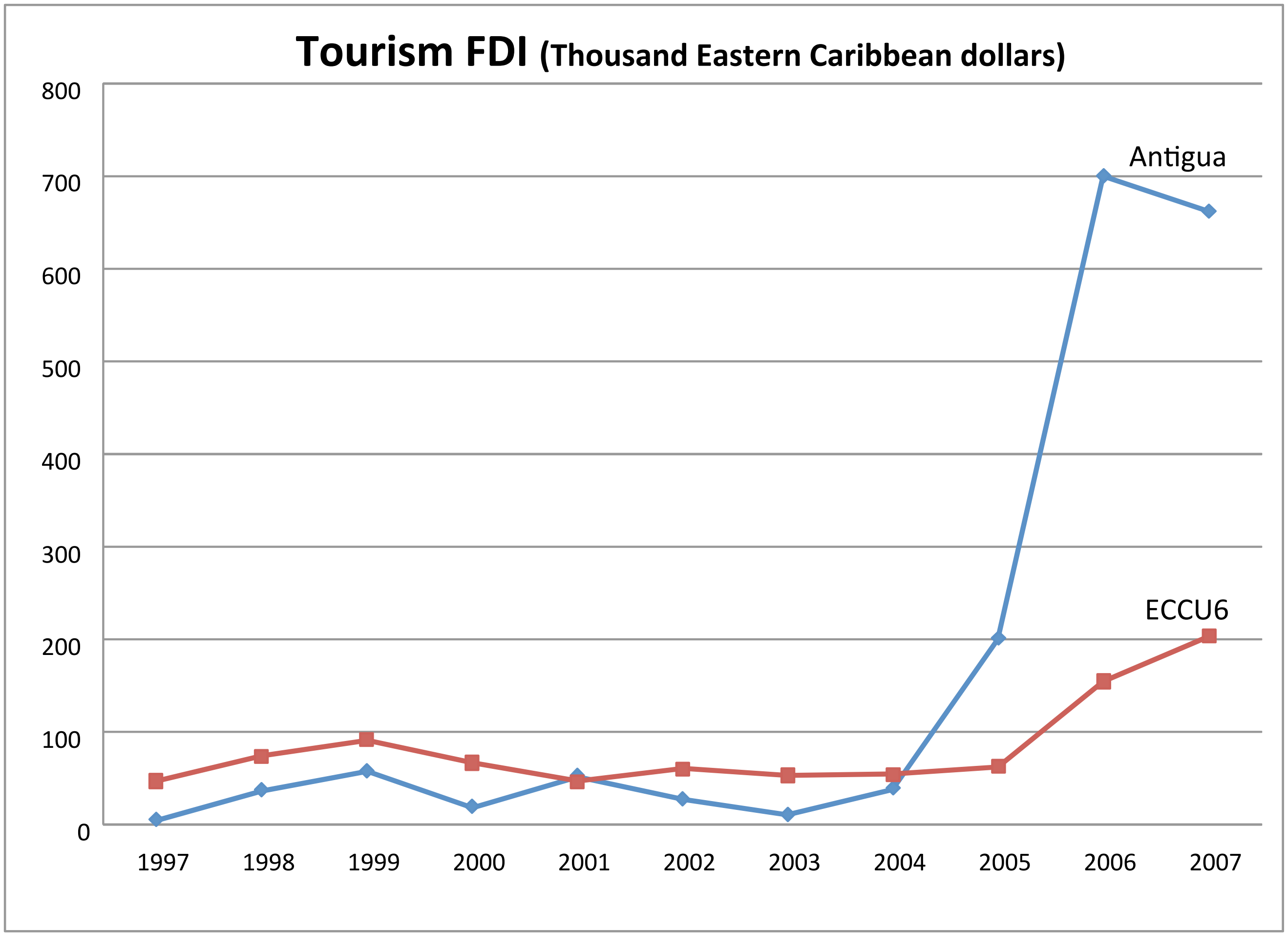
The cost of tax incentives are non-trivial in many countries

Impact of Investment Incentives in West & Central Africa



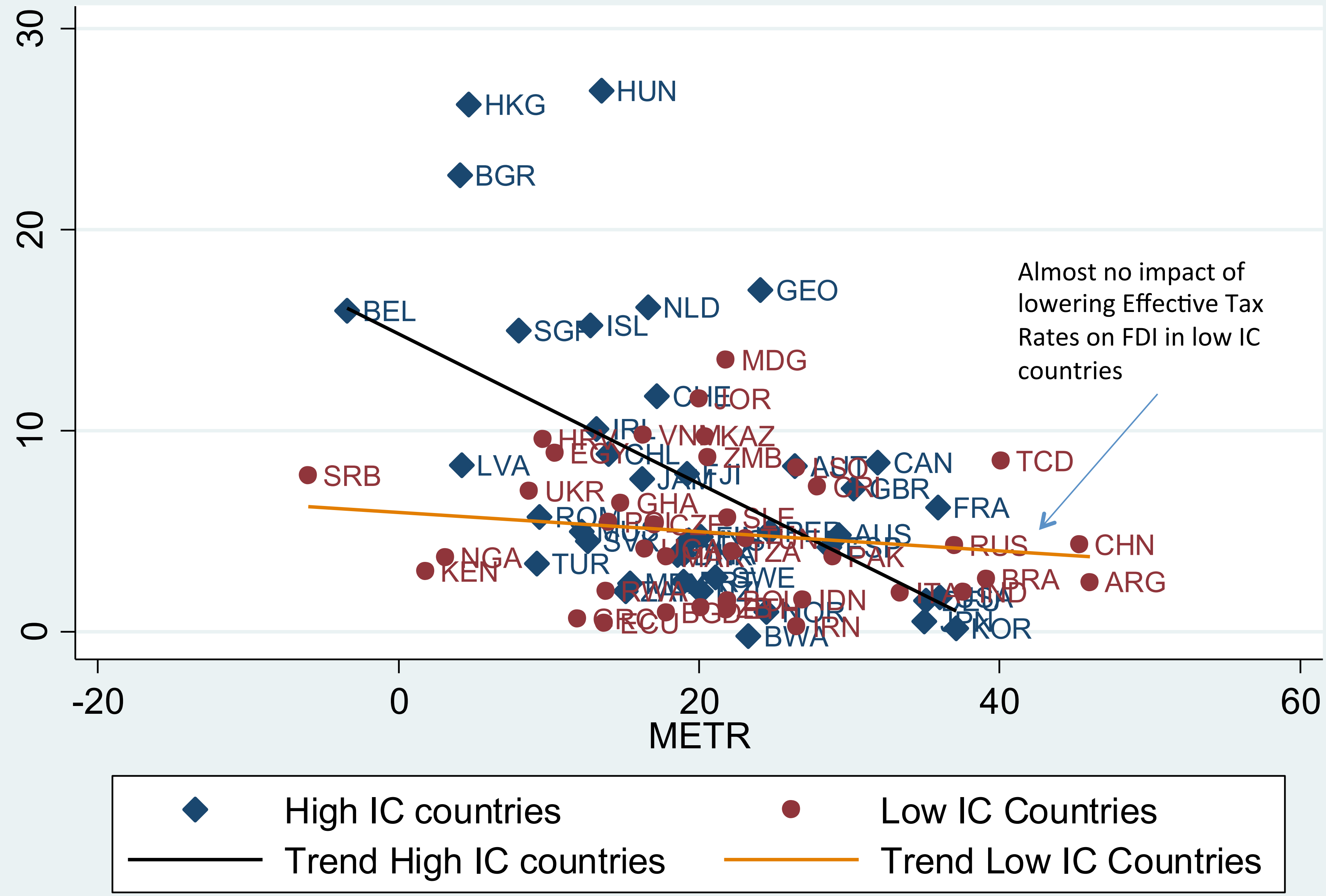
Finding in OECS Case Study

Tourism Incentives ⇧ → **Tourism Investment ⇧**



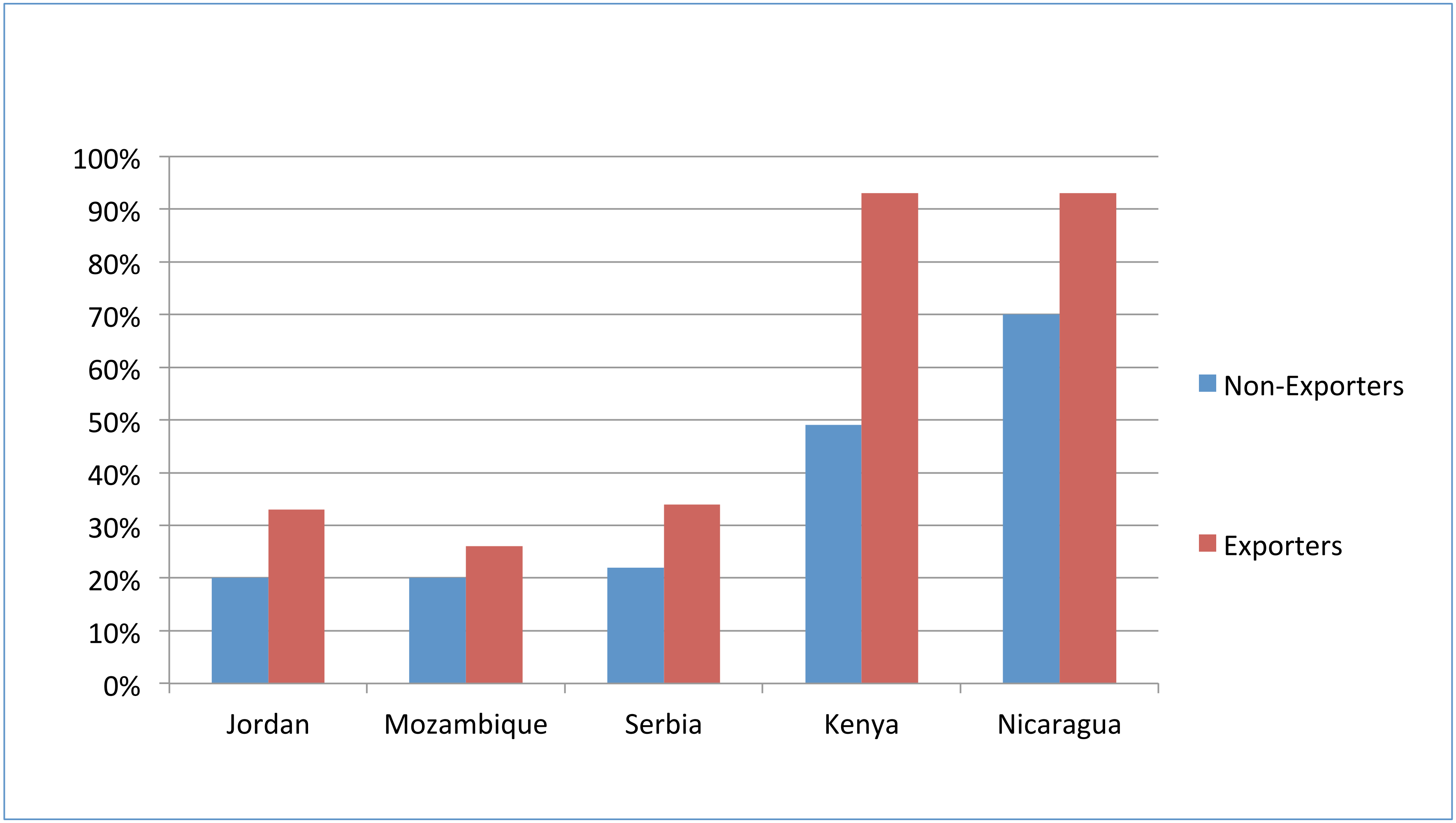
Source: James and Van Parys, 2009

Fiscal Policy Effectiveness and the Investment Climate

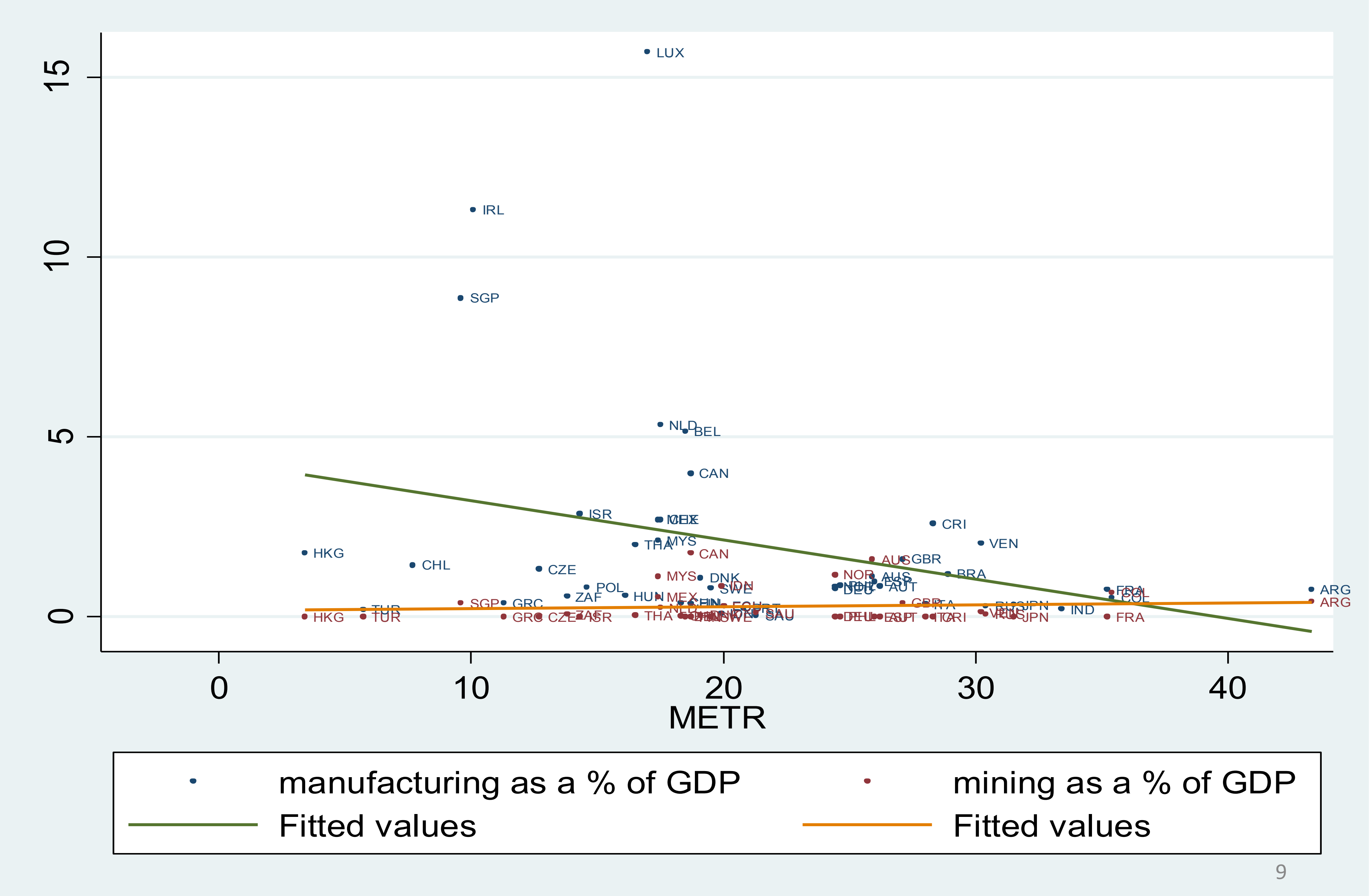


Source: James and Van Parys, 2009

Investors who would NOT have invested without tax Incentives



US Outbound FDI and METR in host countries



Typology of FDI and response to Tax Incentives

Type of Investment	Factors that drive it	Response to investment incentives
Natural Resource/ Skill-seeking FDI	Location of Natural Resources/Skills	Low response. FDI driven primarily by non-tax factors.
Market-seeking FDI	Market potential - Market dimensions - Income per-capita - Customer specific preferences - Kind of goods and services to be provided	Low response. Level playing field between firms is critical (same tax system for all competitors).
Strategic Asset-seeking FDI	Acquiring Strategic Assets - 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 - Mostly export oriented - Availability of skills at a Low cost skills - 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.

Cost of discretion in granting tax incentives

Countries Surveyed	Average delay in days for granting of incentives Answer to the question, "Approximately how many days/weeks/months were required to obtain the incentives over and above the time needed for standard registration and start-up procedures?"	Discretion in allotting the tax incentive?
Serbia	6	No
Rwanda	10	No
Tanzania	15	No
Uganda	18	No
Jordan	21	Yes
Nicaragua	42	No
Burundi	47	Yes
Kenya	63	Yes
Guinea	80	Yes
Tunisia	95	Yes

Cost v. Benefit of Tax Incentives - Jobs

Country Surveyed	Marginal Investors as a % of total Investors	Jobs Created by Marginal Investors as a % of total jobs created	(%) Jobs by Marginal Investors – (%) of Marginal Investors
Burundi	23%	19%	-4%
Guinea	8%	13%	5%
Jordan	30%	21%	-9%
Kenya	39%	42%	3%
Mozambique	22%	15%	-7%
Rwanda	2%	1%	-1%
Serbia	29%	31%	2%
Tanzania	9%	16%	7%
Thailand	19%	-	-
Tunisia	42%	35%	-7%
Uganda	7%	7%	0%
Vietnam		-	-