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How to deal with the growing incentives competition

by
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As I discussed in an earlier *Perspective*,[1] the use of investment incentives is pervasive and growing. The most recent example of a big bidding war was when Boeing threatened to move production of its 777-X aircraft out of Washington state, prompting some 20 states to offer incentive packages to the company (including $1.7 billion from Missouri). In the end, Washington gave Boeing a package of tax incentives worth a record-breaking $8.7 billion over the 2025 – 2040 period to stay, and the unions made substantial concessions regarding pensions.

What can be done to control such auctions, which are often international in scope? The most robust control method, regional in scope, is embodied in the European Union (EU) Guidelines on Regional Aid. These rules guarantee transparency, set variable limits (in terms of "aid intensity," which equals subsidy/investment) for aid levels based on each region's per capita income, and reduce the value of aid to large investment projects over €50 million. They require projects to stay at least five years and mandate the use of clawbacks for firms that fail to meet their commitments in investment contracts. Moreover, the guidelines provide demerits for firms in a dominant position in their industry, although they do not mandate a particular reduction in aid.

The other international control measure comes under the World Trade Organization (WTO) Agreement on Subsidies and Countervailing Measures. While these rules are more tailored to production subsidies than to investment incentives, the latter certainly come under the purview of the Agreement as well, as illustrated by the EU's successful complaint against subsidies for Boeing in the states of Washington, Illinois and Kansas.

However, this case also illustrates the limits of WTO subsidy control. The EU has already filed a compliance complaint,[2] and there is little likelihood the United States (US) will comply anytime soon (the US Trade Representative's office claims that the US has complied, but as long as the state and local tax credits continue in Washington state, that is not correct). Indeed, as mentioned, Washington state has approved a new round of subsidies for Boeing that is likely to initiate a new WTO dispute.

In addition, while the WTO rules require frequent notification of subsidies, there is no penalty for failure to notify, with the result that subsidy notifications are of very uneven quality. Federal states outside the EU frequently make poor quality notifications regarding subnational subsidies. Finally, the TRIMs and GATS agreements regulate performance requirements, but not investment incentives.

What, then, can be done against incentives competition? First, there must be continuing efforts to improve the transparency of location subsidies. This is necessary for jurisdictions to make effective investment promotion policy (especially in a region such as the European Union and the United States, where there are many competing governments) as well as for international policy discussion.

Second, the EU's example shows that incorporating subsidies rules into regional agreements can be a fruitful way to bring bidding wars under control. For many products, such as automobile assembly and steel, corporate location decisions still focus on a single region, meaning that such rules would be geographically comprehensive enough for a variety of industries. Consequently, major stakeholders—including the Columbia Center on Sustainable Investment, the International Institute for Sustainable Development, the United Nations Conference on Trade and Development, the World Association of Investment Promotion Agencies, the International Monetary Fund, the World Bank, and the Organisation for Economic Co-operation and Development—should unite in promoting location subsidy guidelines within regional trade areas. There are no doubt numerous other non-governmental organizations that would endorse such a move.

Third, WTO notifications should be strengthened. Incomplete notifications should be flagged and countries involved should be pressured to give cost estimates for subsidies at all levels of government. Still, it is difficult to envision that sanctions for non-compliance will be introduced.

Fourth, no-raiding zones could be a first step for countries to negotiate controls over investment subsidies. A no-raiding agreement simply commits a state to not give a subsidy to relocate an existing facility from another state; it would not apply to new investments. Their track record is mixed—several agreements among US states are failing quickly, but Australia (2003-2011) and Canada (1994-present) have been more successful.[3] Despite these mixed results, it is easier to demonstrate to policymakers the futility of relocation subsidies, since they create no new jobs, than it is to do for incentives for new investment, which could make this a more feasible first step.

Though national and subnational jurisdictions have incentives to offer location subsidies, these proposed measures would help keep their value to more reasonable levels with a lower likelihood of distorting competition and international investment flows.

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[1] Kenneth P. Thomas, "Investment incentives and the global competition for capital," *Columbia FDI Perspectives*, No. 54, December 30, 2011.

[2] Emelie Rutherford, "EU wants $12 billion in U.S. sanctions over Boeing subsidy spat," *Defense Daily*, September 27, 2012.

[3] Kenneth P. Thomas, "Regulating investment attraction: Canada's Code of Conduct on Incentives in a comparative context," 37 *Canadian Public Policy*, 3 (2011), pp. 343-357; Kenneth P. Thomas, "EU control of state aid to mobile investment in comparative perspective," 34 *Journal of European Integration* 6 (2012), pp. 567-584.

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