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INCENTIVES-BASED COMPETITION FOR FDI IN DEVELOPING COUNTRIES

Findings of a joint WAIPA/OECD questionnaire

May 2003

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1. This note was prepared with the purpose of addressing questions occasionally raised in the context of investment incentives offered by developing, emerging and transition economies. In a nutshell, the main issues are: (i) to what extent do such countries compete with each other for the same foreign direct investment (FDI)? And (ii) can cases of competition between mature economies and countries on a lover level of development be demonstrated? These issues were already addressed in a major study by the OECD Development Centre in 2000, the main focus of which, however, was the process of offering incentives rather than incentives-based competition *per se*. Some of the main findings bearing on the topic of the present note are summarised in the text box below.

2. In an attempt to build on the findings of Development Centre's study a survey was developed jointly by the OECD and WAIPA secretariat and sent to 65 WAIPA members. The addressees were picked among countries classified by the United Nations as being located in "developing countries" -- i.e. countries habitually referred to by the OECD as being either developing, emerging or transition economies.

3. All addressees were asked the below four questions. The respondents were in each case asked to provide details, including whether such practices, if they had indeed taken place, involved countries that are characterised as 'developing' according to UN standards.

1. Has your country or jurisdiction ever granted or increased investment incentives in response to those offered by other locations?
2. Has your country or jurisdiction experienced the withdrawal of enterprises in response to incentives offered by other locations?
3. Have you any evidence of foreign enterprises that were actively considering investing in your country or jurisdiction being induced to choose an alternative overseas location?
4. Have you any evidence of foreign enterprises that were otherwise likely to relocate to your country or jurisdiction being discouraged from doing so by the authorities in their present host location?

4. Nineteen WAIPA members responded, some of whom on the condition of anonymity. The respondents were located in Latin America including the Caribbean area (9 responses), Europe (7 responses), Asia (2 responses) and Africa (1 response). Section I summarises the responses in overview tables and surveys the main findings. Section II draws a few tentative conclusions.

Box. The OECD Development Centre's study of FDI incentives

The OECD Development Centre published a study of FDI incentives in selected countries in 2000[1]. While the objective of this study was not to compare countries on different levels of economic development, it nevertheless yielded some insights of general interest in this regard. The purpose of the Centre's research was to assess the implications for developing countries of both incentives-based and 'rules-based' competition among national and sub-national governments in developing and OECD countries to attract foreign direct investment in the 'real' (as opposed to financial) sector. The findings of the study are based on empirical research carried out in the late 1990s by local researchers, under the Centre's direction, in Argentina, Brazil, China, India, Malaysia, Singapore, Mexico, Canada, the United States and western Europe.

One finding of the study was that, whether or not governments are fully aware of it (often they are not), competition among them to attract FDI effectively takes place much more *within* than between the three major regions of today's global economy. These are defined for the purpose of the study as Asia, the Western Hemisphere and 'greater' Europe (which can be defined here to include all countries bordering the Mediterranean). While some cases of competition were found, for example between Singapore and Ireland, such inter-regional competition is exceptional.

Within regions, there is some evidence of competition between higher- and lower-income countries. An example widely quoted in the press in the early 1990s was the case of Mexico and a few states in the United States for the $300 million BMW automobile plant that ultimately went to South Carolina[2]. Mexico also appears to have "diverted" significant FDI away from several Caribbean Basin countries, though the country's adherence to NAFTA has almost certainly been a more important motivating factor than the use of fiscal or financial incentives. In Asia, the competition is largely among non-OECD countries. Within 'greater Europe', there is evidence of competition among some North African, eastern European and southern European countries, though, again, it is "rules-based" competition (especially EU membership) more than the use of fiscal or financial incentives that tends to determine the outcome.

1 C. Oman, *Policy Competition for Foreign Direct Investment: A Study of Competition Among Governments to Attract FDI*, OECD Development Centre, Paris, 2000.

2 In addition to promises of stable tax rates for 20 years and an income-tax credit of $1500 per new job, South Carolina reportedly provided BMW an incentive package totalling some US$115 million.

I. Evidence from WAIPA member countries

Question 1: Granting or increasing incentives in response to those offered by other locations?

Region	*Yes*	*No*	*To some extent*	*Comments*
Asia/Africa	-	2	1	Some countries/jurisdictions have raised the general level of generosity of their incentives in response to those on offer elsewhere. Few have reportedly done so with a view to targeting individual investors or investment projects.
Europe	-	6	1	
Latin America	1	6	2	
Total	1	14	4	

5. Perhaps unsurprisingly, few respondents volunteered information confirming that they had engaged in outright practices of topping bids for individual investment projects. However, several respondents said that the overall generosity of their FDI incentive schemes was chosen with a view to be competitive vis-à-vis alternative locations in developing countries -- a phenomenon commonly referred to as 'regime competition'.

6. No respondents cited evidence of regime competition or competition for individual investment projects between developed and developing countries.

Question 2: Withdrawal of enterprises in response to incentives offered by other locations?

Region	*Yes*	*No*	*To some extent*	*Comments*
Asia/Africa	-	3	-	Some respondents noted that relocation has taken place under the influence of a host of factors, incentives being only one of them.
Europe	-	4	3	
Latin America	2	6	1	
Total	2	13	4	

7. More than half of the respondents assessed that they had 'lost' enterprises to other locations. However, they were mostly uncertain how much of this should be ascribed to the effects of investment incentives. In most of the reported cases, the withdrawal of enterprises appears to reflect low-tech or labour intensive industries relocating to (even) less developed countries, in which process incentives played only a limited role.

8. There was no indication that similar relocations between developed and developing countries are of concern to the respondents.

Question 3: Enterprises that were actively considering investing being induced to choose an alternative overseas location?

Region	*Yes*	*No*	*To some extent*	*Comments*
Asia/Africa	1	2	-	There is a presumption among respondents that this may have been a factor, but little concrete evidence can be provided.
Europe	1	5	1	
Latin America	1	6	2	
Total	3	13	3	

9. Several respondents indicated that they had lost investment projects they had strongly believed were 'in the bag' due to incentives offered by other locations. While some put this down to the general practice of investors shopping around for the best incentives, others took the position that the process of bidding for individual investment projects sometimes goes way beyond that. The strongest indication of "poaching" of individual investment projects came from a Latin American respondent. It related to the incentive practices in connection with the national "auto regime". Also, one Caribbean respondent noted a general tendency to poaching FDI project within the region.

10. Again, the respondents offered virtually no indication of this being a problem between developed and developing countries.

d) Question 4: Enterprises that were likely to relocate to your country or jurisdiction being discouraged from doing so?

Region	*Yes*	*No*	*To some extent*	*Comments*
Asia/Africa	-	3	-	The affirmative responses all relate to the car industry.
Europe	3	3	1	
Latin America	-	9	-	
Total	3	15	1	

11. Finally, the only concrete pieces of evidence of incentive competition between developed and developing countries emanated from Question 4. Three European transition economies asserted that investment promised by a developed European country's auto companies had on some occasions failed to materialise due to increased subsidisation by their present host locations. The respondents noted that the initiative for such anti-relocation subsidies is generally taken at the sub-national level.

II. Summing up

12. First and foremost, no firm conclusions should be drawn on the basis of a questionnaire exercise in which only nineteen jurisdictions participated. This is further accentuated by the fact that a couple of WAIPA members that have been mentioned by the media as being very active in offering investment incentives expressly declined to participate, which may be taken to indicate a problem with "adverse selection" of the respondents. Nevertheless, the outcome of the questionnaire, combined with the earlier study by OECD Development Centre, lends itself to the following general findings.

13. While many developing countries (and, not least, sub-national levels of government) engage in either proactive or defensive incentive strategies aimed at attracting FDI in competition with other locations, there are very few cases of them being in direct competition with developed economies. The reasons for this would appear to include at least three limiting factors. First, the vast majority of competition for FDI takes place within given regions, whereby only the relatively few developing countries that are situated close to developed nations are likely candidates. Second, competition is only likely where investors are somewhat indifferent between alternative locations. This implies that only the relatively more advanced economies (i.e. countries that are classified as 'emerging' or 'in transition') could have cause to bid against developed nations. Third, overt "bidding wars" are relatively rare and limited to a few sectors. They generally occur where individual projects are unusually large and the sectors in question are considered as a high priority for national or regional economic strategies.

14. In consequence, the documented cases of direct incentive competition between developing and developed countries are largely limited to a small number of 'trophy projects' in sub-sectors such as the auto and electronics industries. On the basis of the available information, almost all of these cases relate to competition between EU countries and their neighbours and competition among the NAFTA economies.