How to deal with the growing incentives competition
by
Kenneth P. Thomas*

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. 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.

---

1 Kenneth P. Thomas (kpthomas@umsl.edu) is Professor of Political Science at the University of Missouri-St. Louis. The author is grateful to Lise Johnson, Sebastian James and Peter Nunnenkamp for their helpful peer reviews. The views expressed by the author of this Perspective do not necessarily reflect the opinions of Columbia University or its partners and supporters. Columbia FDI Perspectives (ISSN 2158-3579) is a peer-reviewed series.


The material in this Perspective may be reprinted if accompanied by the following acknowledgment: “Kenneth P. Thomas, ‘How to deal with the growing incentives competition,’ *Columbia FDI Perspectives*, No. 131, September 29, 2014. Reprinted with permission from the Columbia Center on Sustainable Investment (www.ccsi.columbia.edu).” A copy should kindly be sent to the Columbia Center on Sustainable Investment at ccsi@law.columbia.edu.

For further information, including information regarding submission to the *Perspectives*, please contact: Columbia Center on Sustainable Investment, Adrian Torres, adrian.p.torres@gmail.com or adrian.torres@law.columbia.edu.

The Columbia Center on Sustainable Investment (CCSI), a joint center of Columbia Law School and the Earth Institute at Columbia University, is a leading applied research center and forum dedicated to the study, practice and discussion of sustainable international investment. Our mission is to develop and disseminate practical approaches and solutions, as well as to analyze topical policy-oriented issues, in order to maximize the impact of international investment for sustainable development. The Center undertakes its mission through interdisciplinary research, advisory projects, multi-stakeholder dialogue, educational programs, and the development of resources and tools. For more information, visit us at www.ccsi.columbia.edu.

**Most recent Columbia FDI Perspectives**

- No. 130, Catherine Kessedjian, “Good governance of third party funding,” September 15, 2014

All previous FDI Perspectives are available at http://ccsi.columbia.edu/publications/columbia-fdi-perspectives/.