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EU - China and the non-transparent race for inward FDI

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Abstract

In this paper it is argued that the restructuring following the stiffer competition stemming from increased global integration will trigger a race between countries to attract inward foreign direct investment (FDI). It is further argued that this race consists of last minute efforts and tailor-made packages designed by governments and their agencies to temporarily improve their country's otherwise inferior (O)L(I) profile. The race is non-transparent and the factors used to compete for inward FDI (the 'elements' of the race) deviates from those of the long-term efforts to develop a favourable investment climate and improved productivity and medium-term efforts, such as, for instance, a general lowering of corporate taxes. The paper elaborates on the research problem of properly understanding the drivers of inward FDI in the absence of data on the elements of the race. It also addresses the economic policy problem following from this race under a scenario where the bulk of inward FDI ends up in China and India, putting the cohesion of the European Union at stake.

Key words: Inward FDI, China, European Union, OLI, investment-diverting policies

JEL: E61, F15, F21, F23, F36, F42, G18, G34

EU - China and the non-transparent race for inward FDI

1. INTRODUCTION

During the last three decades, the dismantling of cross-border controls, improvements of information technologies and increased privatization have contributed to profound changes in the global economic map. As part of this process we have witnessed a considerable revision of investment regimes in a positive direction. In 2004, 85 percent of 271 regulatory changes undertaken by 102 countries were favourable to foreign direct investment (FDI) (UNCTAD, 2005). The expansion of the European Union (EU) to 27 member countries in January, 2007 and the completion of the first round of the European Economic and Monetary Union (EMU) with 12 member countries (1999 - 2002) having a common currency and central bank are other important changes of the global economic landscape crucial to the emergence of global disequilibrium. Moreover, the appearance of China and India as "global factories" or service suppliers is also claimed to be of vital importance to such an emergence.

After a peak in 2000, FDI-flows decreased by almost 35 percent the following five years. A closer look at FDI inflows reveal that the developing economies have increased their flows by about 25% whereas developed economies are severely hit and

down to flows corresponding to about half their 2000-value. In terms of FDI “market shares” the developed economies lost a little bit more than 20 percentage points (a drop from 80 per cent to 59 percent), whereas the developing economies gained almost 17 percentage points and reached 36 percent, the highest share since 1997.¹ The share of FDI for developed countries in thus decreasing dramatically while the share for developing countries is increasing at a steady and consistent pace (see Figure1).

INSERT FIGURE 1 HERE

A point of departure for this paper is that the increased economic integration fosters increased competition that calls for a restructuring of global industries. Economic activities (e.g. production) are moving to sites that can provide the best conditions for these activities. A new global equilibrium will emerge where China and India are the new production sites attracting FDI that previously may have materialized in the developed world. This new equilibrium, however, poses a threat to policymakers in developed countries in general and in the EU in particular (Oxelheim and Ghauri, 2004). The EMU countries today have not much leeway to look attractive by using the macroeconomic situation to their best advantage. With common monetary policy and a shrinking room for autonomous fiscal policy they will all look equally attractive from a macroeconomic point of view. The UNCTAD (2005)-survey referred to below indicates a low interest in small, peripheral EU countries. The survey also indicates prospects for a dramatical increase in the use of investment policy measures from 2004 and the next couple of years. In this paper, we argue, based on historic analogies, that policy-makers in the EU

¹ Based on figures from UNCTAD 2006.

countries, as a response to the prospects of losing FDI to China and India, will fight for inward investment using “grey” measures. A temporary disequilibrium will emerge as a result of this race for inward FDI.

The race can also take other forms than the one with governments taking the initiative. In recent years we have seen a race in which the initiative comes from individual companies and that shows some resemblance with black mailing. General Motors (GM), for instance, in 2005 urged under the threat of a close-down a number of production plants in Europe to compete with each other and to convince GM which ones deserved to survive. Saab’s production site in Trollhättan (Sweden) had to compete with GM’s production site in Rüsselsheim (Germany) about the production of the third generation of GM’s middle range cars. This competition saw all kinds and levels of governments, authorities and labour unions involved in offering different incentives in a package aimed at boosting the chances of having their site survive. Hence, though GM headquarter urged the subsidiaries to show their future ability, this ability was strengthened by incentives and efforts provided by many other stakeholders. For instance, some days before the decision was supposed to be taken the Swedish prime minister travelled to GM’s European headquarter to meet with its top-management team. It is not too bold to assume that the trip was not for courtesy but to provide a last set of offers to tip the decision in favour of a production in Trollhättan. The German chancellor Gerhard Schröder at that time almost declared an “industrial war”; promising to do *all* he could to bring the production to Rüsselsheim. Hence, we already see indications that with a stiffer investment climate, i.e. with China and India attracting the bulk of FDI flows, the cohesion of the EU may be threatened. Finally, companies may also ask up-front what a

government can offer in order to win the competition for their cross-border investment as in e.g. Slovakia (Blomberg, 2005).

We argue that in order to properly understand, model and test the magnitude of FDI inflows to a country, the role of the race and this form of investment diverging policies have to be taken into account. These policies, aiming at improving the attractiveness as a last minute measure when the investment is on its way to pass by, are to be seen as the economic equivalent of anabolic steroids, a short-cut to become beautiful but with uncertain long-term repercussions. These policies are a way to alter the OLI-configuration over night. From a research point of view, and a potential explanation why these policies are not empirically tested, there exists a problematic lack of data as politicians do not want to have these grey-area measures registered. In the absence of other than the anecdotal evidence, we, in this paper, analyze the race for foreign direct investment with a normative lens.

Although we focus on the race at the governmental level we acknowledge that the race for inward FDI is a multilevel issue. EU-authorities may try to attract inward FDI to the region that are then the target of the race at the country level. Once a country has successfully managed to attract the FDI there may follow a race at the local government-level that maybe ends up in a race at the city-level.

The paper is organized as follows. In Section 2 we provide some stylized facts about the FDI balance between the EU and China and in Section 3 we provide the background to the race for foreign direct investment. Section 4 deals with the different incentives that trigger the race for inward FDI. In Section 5, the costs and benefits of the race are presented. Section 6 discusses the regulatory body adopted by the EU and the

WTO aimed at preventing a race to develop. Finally, Section 7 provides concluding remarks.

2. INWARD FDI – SOME STYLIZED FACTS FOR CHINA AND THE EU

In the group of developing economies, China has increased its inflows by almost 80% in the period and was in 2005 the number three recipient of inward FDI, after the US and the UK. China's market share increased in the early 2000s and reached about 8 percent in 2005 (12 percent with Hong Kong included). Admittedly, the potential measurement error may be large and as reported in the UNCTAD FDI/TNC database may amount to a divergence of about 80% as in the case of the US investment in China in 2002 (5240 million dollars reported by Chinese authorities as compared to only 924 million of dollars as reported by US authorities). This error, however, often refers to contracted versus actual FDI, which is illustrated in the Table 1 below. Together with China, India is often mentioned to increasingly attract inward FDI. However, India is still receiving much less than China; having a market share of less than 1 percent in 2004. The relevant observation for this study is that China and India both gain market shares.

INSERT TABLE 1

In 2004, the EU faced a new and tough reality. First, EU faced a close to 50% decrease of inflows from 2002. Second, the EU was surpassed by the developing world

for the first time in terms of inward FDI (233 vis-à-vis 216 out of a global total of 648 billions of dollars). China, Hong-Kong/China, Korea and India attracted close to 50 percent of the inflows to the developing world. EU lost shares on a shrinking market.

As to the prospects, we may find many indications for an increasing importance of China and India. In a study by UNCTAD (2005) 85% of global FDI experts and 87% of global transnational corporations considered China the most attractive investment location. Figure 2 Shows that China is catching up as the most attractive location for FDI. India was ranked number three by global FDI experts (42%) and number two by global transnational corporations (51%). For the time span 2005-2009 a survey indicates that the most attractive prospective R&D location is China (61.8%) followed by the US (41,2%) and India (29,4%). Members of the European Union are found less attractive. The UK is ranked number five (13,2%) followed by France (8.8%) as number seven and Germany (5.9%) as number eight. The result, however, is much tougher for the small European countries with for instance Ireland and Sweden receiving just 1.5% of the responses in the survey.

INSERT FIGURE 2

“Grey” measures - if and when used - will mean a temporary disequilibrium. China and India can remain or react by using these grey measures themselves. To some extent they already do so. Actually, a major institutional reform took place already 1979 when specific policy preferentials to attract foreign direct investment were designated. These policies later led to the first establishment of Special Economic Zones and to a later

opening of coastal provinces for inward FDI. In this context, the Guangdong province (since long ago a top-recipient of inward FDI) became the designated showroom (Ng and Tuan, 2001).

The Chinese FDI policies have changed over time and differed from one region to another. Reflecting different stages of the economic reform process, we see regional differences expressed in the creation of Special Economic zones, Coastal Economic Zones and Central Reform Testing Zones. The policies have also given foreign direct investors preferential tax treatment (tax rates and tax holidays) to stimulate cooperation between multinational companies and local enterprises (Ng and Tuan, 2001). A beneficial tax rate for foreign direct investors is still offered. The Chinese deregulation and opening up for inward FDI was experimental in design and gradual following the Chinese proverb “for unfamiliar rivers, touching the stone at the river bed is the best strategy to cross the river” (Child, 2001). Part of the efforts devoted to attract inward FDI to China has been spent on creating an investor friendly investment environment in structural dimensions: a “hard” dimension regarding physical infrastructure, a “soft” involving administrative infrastructure and a third dimension containing the social-economic factors (Li and Li, 1999; Lu and Tsai, 2000)

Hence, we have just seen the first tentative move of China as regards their involvement in the race, which resulted in an increase of 19.42 percent in actual utilised FDI in 2005 over the previous year (www.fdi.gov.cn). This indicates that China in the future will be increasingly active in the race for inward FDI. To sum up, this paper focuses on the prospect of a global race for foreign direct investment that will result in a temporary disequilibrium in the global economic activity.

In addition, we argue that China and India, by receiving an increasing share of global FDI flows, will trigger an intra-EU race for FDI. The restructuring process within the EU will take time and some governments will be tempted to take shortcuts to an improved market position. They will find new ways to convince foreign investors to opt for their country by the use of incentives in the “grey” area or even incentives that may be labelled “unfair”. It is not only a matter of attracting new investments but also relocating existing investments from one place to another. For example, in 2000, the German tire-maker Continental moved its production from a small village in Sweden to Portugal. An artificially low production cost – subsidised by EU to an amount of 50 million euros – was claimed to have caused a painful close down with about 500 lost jobs in one EU country at the expense of the emergence of a new production location in another EU country. In a similar way, in 2002 Ford received about 20 million euros in regional support to expand its production of Volvo car engines in Wales. As a result of the expansion, Ford decided to close down its production in another EU country, which happened to be Sweden also in this case.

3. BACKGROUND TO THE RACE FOR FOREIGN DIRECT INVESTMENT

The playing field for foreign direct investment changed substantially during the 1980s. During most of the post-WW2 period up to the 1980s, inward FDI were seen with some scepticism. The negative view was often a result of a mistake by governments from inviting only selected firms to invest in their country. Despite the fact that the selected

firm mostly was at the leading edge of technology and management skill, the mere procedure of inviting only *one* firm in a particular sector made many countries miss most of the benefits from inward FDI and end up with bad experiences.

In a historical perspective, the expansion of FDI in the 1980s had its parallel in the trade expansion of the 1950s and 1960s. While the international trade expansion was fuelled by multilateral trade liberalization, the FDI expansion was to a large extent prompted by the global abolition of capital controls. In the 1980s borders were opened up and inward FDI were in most countries no longer restricted. Economic integration increased, stimulated by increased financial integration². Governments started to realize the benefits that may accrue to them and saw suddenly inward FDI as the remedy to many domestic problems.

The increased financial integration was propelled by a variety of forces; improvements in the information technology and a general wave of deregulation being the strongest. The deregulation was to some extent just an acknowledgement (*de jure*) by the authorities that existing regulations had eroded and (*de facto*) become inefficient (Oxelheim, 1996). But the deregulation was also an expression of a change in the philosophy underlying national economic policy in the 1980s, reflecting a growing insight that excessive controls are not compatible with efficient resource allocation and a balanced economic growth.

The regulatory changes differed substantially between countries in respect to timing, activities of supervisory authorities and content of external and internal deregulatory measures. Among the external measures, the abolition of capital controls and a

² From a conceptual point of view the two forms of integration are overlapping, since them both include foreign direct investment. From a causal point of view it can be claimed that the financial integration was triggered and made inevitable by the increased internationalization of firms.

general opening up for inward FDI were the most important ones. Within the group of internal measures, the relaxation of limits on activities in which different firms may engage and the rules that discriminate against foreign-owned firms deserves to be mentioned in this context.

Once the deregulation had opened up the way for FDI, several structural forces fuelled the growth of FDI. Increased regionalization (EU, NAFTA, etc) and the “outsider’s” fear of increased protection and discrimination, maturing markets for international mergers and acquisitions (M&A), and the increasing role of services, which at the beginning of the 2000s accounted for 50-55 percent of total FDI outflows from most major source countries are the most prominent examples of these forces (UNCTAD 2005). Globalisation and regional integration on the one hand and technological and commercial know-how of MNEs on the other transformed the relationship between governments and MNEs from a position of confrontation to a position characterized by openness and bargaining over investments.

To control for “unfair” competition between countries a need for supranational supervision was emphasized (Oxelheim 1993). Unfortunately, at the beginning of the 1990’s there was no global institution committed to this task, though the OECD, the IMF, the World Bank and the GATT all were potential candidates for this role. The European Union (EU), however, did assume the role of supranational authority in a regional framework. Extensive efforts have been made to prevent an unfair competition among the EU-members. The question is then to what extent these efforts have been sufficient to curb a movement towards increased competition between EU’s member states for inward FDI? It is a delicate task to nail-down those governments that have participated in a race

pretending e.g a potential sale of an under-priced building to the investing company being just a bad business deal?

3.1 EU and China as a trigger for a new race

In the 1990s, a veritable ‘race’ for inward FDI was visible as a means to solve the problem of a growing unemployment (Oxelheim, 1993; Oxelheim and Ghauri, 2004). Countries that experienced low growth or recession were inclined to use measures in the “grey” area of fair competition. This area may be broad due to problems of identifying what “fair” should mean. What is seen as fair competition by one government might be seen as unfair competition by another government.

Governments started to “elbow” out their competitors in attracting inward FDI by the use of economic equivalents of anabolic steroids. The net effect of the race and the magnitude of the repercussions (to the extent they have already accrued) are seldom reported. The fierce competition for inward investment did also create losers. Frustrated governments that were not willing to compete with the same unfair means or that were unsuccessful in the race may have considered retaliation by imposing restrictions on capital movement. The closer the end of the political mandate and a new election the bigger is the temptation. Despite periods of temporary increases of restrictions there is no evidence that this early version of the race actually triggered a wave of re-regulation (Oxelheim 1996).

The losers blamed governments of successful host countries for their own failures. In this respect we can once again see a parallel in international trade. This time we have a parallel in the Omnibus Trade Act (1988) that granted US authorities the right to bilateral

negotiations with representatives of countries that, according to the US view, had applied unfair trade practice. Hence, triggering a retreat from a multi- to a bilateral world. In a global recession, there will be many interpretations about what is “fair” or not.

In a world of perfect financial integration, expected real returns will be the same on projects that are identical except for currencies and jurisdictions. The international purchasing power parity and the international Fisher parity both prevail. The EU is moving in that direction; with one currency adopted by all member states and one policy for all. Hence inside the EU, perfect monetary and political integration will prevail. In such a world, where regulatory barriers have been removed, taxes harmonized, takeover defenses dismantled, economic policymaking coordinated, accounting principles and disclosure norms harmonized, and transactions cost suppressed to a minimum, there is little left for governments to use in the competition for inward FDI within a truly fair competition framework. However if we broaden the scope and look into the grey area, i.e. into the borderland between fair and unfair competition, we may identify five categories of incentives for the politicians to package in a selective or tailor made fashion rather than in a general policy framework.

We argue that in a region like the EU, the government and its agents in an individual member country will search for new ways to stand out with an FDI seducing profile and to look attractive in order to reap all the benefits from the kind of inward FDI it is looking for. History provides numerous examples of competitive devaluations and other efforts to transfer own problems on to neighbouring countries. A new “grey” area will emerge or the old one re-appear in a slightly different form. We will see tailor made selective (aimed at targeted firms) policies emerge in many countries with the aim of

attracting inward FDI. In the best of worlds these policies will be compatible with “fair” competition and broadly speaking geared at improving national productivity and knowledge creation. However, governments under pressure will not remain inactive and watch all FDI end up in neighbouring countries. China’s attractiveness will put EU member states’ governments under such pressure.

Within the EU, many companies have benefited from *known* tax reductions when making their location decisions. Some countries like Belgium, Ireland and the Netherlands offer reductions in particular to companies that establish their financial centres in these countries. Luxembourg and Portugal have offered “carrots” of similar kind. Recently, EU’s ministers of finance and the EU-commission decided that the tax reductions should be allowed up until at least 2010.

We claim that the EU lends itself to a study of disequilibrium in global production caused by investment diverting policies. As mentioned China and to some extent India will play a crucial role in triggering a propensity by EU member countries to create a deviation from equilibrium. The inclination to participate in the race will probably be different for governments of member countries that are in the periphery technologically as well as geographically as compared to those that are not. Moreover, a study in a EU-framework will also allow conclusions about the responsiveness of companies in different industries to incentives of different kinds provided by different governments, while keeping many institutional factors constant.

The grey area measures we are addressing in this paper could also be put in a policy context as part of an investment diverting policy. According to the Lisbon declaration, the EU-polices should at an aggregate level be *investment creating*. They

should aim at improving the competitive power of the EU region, boost productivity and efficiency. Investment in the EU then comes as a response to new opportunities and improved attractiveness. However, investors from outside the EU may see some of these EU-policies as *investment diverting*. Policies adding to this view are e.g. anti-dumping rules strengthening the outsiders' view of the EU as the Fortress Europe. Government in individual member countries may then pursue their own investment diverting policies. Some policies, for example local content rules, will signal that if you do not produce in a particular maker you will not get access to it. Other policies will work as incentives aimed at convincing the outsider to produce in a particular country by pointing at an "artificially" low production cost – for example made possible through subsidies - as compared to what can be achieved elsewhere.

We rest this paper on the assumption that in an integrated region like the EU there will remain some acceptable incentives to be used by governments to lure inward FDI but in this setting, we claim that the temptation to use old or to invent new forms of incentives that endanger "fair" competition will be big. We will see much of financial creativity and engineering aimed at circumventing regulations and standards or to disguise abusive use of incentives. Hence, we expect to see incentives that are created by policymakers and characterized by having no benchmark position. The new mode is characterized by the key words: targeted firms and tailor made incentive packages.

4. THE ELEMENTS OF THE RACE

The incentives (or elements of the race) given to foreign firms to invest in a particular country may according to Oxelheim (1993) be grouped into five major categories: 1) information advantages and agglomeration support, 2) subsidies and tax packages, 3) looser interpretations of international agreements, 4) cyclical and geographical features and, 5) home country biased consumers. The incentives can be characterized as inherent, such as language advantages, or created, such as subsidies. They may also be distinguished by whether or not they have a benchmark position. Some types of information advantages are examples of incentives that have a benchmark position, since they vanish when a country reaches the information efficiency of the rest of the world. Subsidies belong to this group of incentives that lack a benchmark position, since the upper limit of what a country can offer is very diffuse.

A strand of literature has analysed the dependence of FDI upon location attractiveness (Vernon, 1966; Caves, 1971; Dunning, 1977, 1988, 1995, 1998, 2000; Buckley and Casson, 1976; Hymer, 1976; Rugman, 1980; Ghauri et.al. 2004; Buckley and Ghauri, 1996). Government policies both from home and more importantly from host markets play an important role in forming the location advantage, expressed as the L in the OLI paradigm (Dunning, 1977, 1988, 1995, 1998, 2000; Aharoni 1966; Aliber 1970, Buckley and Ghauri, 2004). What constitute the race are efforts by the government to improve the L advantages in a way that is not entirely compatible with fair competition. The efforts that characterize the race are those intended to change of the OLI configuration in weeks and months rather than in years and decades.

We have so far only mentioned policies for attracting inward FDI. However, in a world of high and growing interdependence these policies often go together with policies

for domestic investment. Policies favourable for domestic investment very often also attract inward FDI. Similarly, policies that make domestic investment unattractive often discourage inward FDI. They encourage outward FDI as home companies and residents look abroad for better uses of their capital. Moreover, a successful campaign from the government in country A to look attractive may result in an out-location of investment from country B to country A. A substitution relationship between outward FDI and investment at home has been found for Schumpeter industries, whereas a complementary relationship has been reported for Heckscher-Ohlin industries (Braunerhjelm and Oxelheim, 2000; Braunerhjelm et al, 2005).

4.1 Information advantages and agglomeration support

The first group of incentives is associated with information in general. Some of the advantages within this category are inherent and not easily eliminated in the integration process. The most distinctive factor is perhaps language. For instance, the difficulty of the Chinese language may in the future trigger inward investment in China even though the country may be integrated in all other dimensions. The Chinese government may also “help” foreign firms to realize the necessity of being present in China by imposing rules, for instance, that all consumer information should be written in Chinese. Governments may turn a language disadvantage into a case for attracting (or pushing) a foreign investment. In the EU-context, we may find that one reason why the United Kingdom has attracted most inward FDI in Europe is the language (Ghauri et.al. 2004). The role of the English language may have been recognized by the Dutch investment agency since

during the 1990 it had several advertisements in the Economist emphasizing the English language as an integrated part of the Dutch business.

Differences in education present another example of an incentive of information character. The incentive is of a benchmark type although measurement problems exist. It can be seen as partly inherent and partly created. What is meant here is not the difference in people's perception and interpretation of different signals that are related to cultural differences, but rather differences in competences. A government may give priority to education in order to attract inward FDI and to persuade domestic firms to invest domestically. Hence, by creating a superior educational system, a country may attract FDI by offering engineers at a competitive wage or rather, in an integrated world, better educated engineers at the same wage as elsewhere. As a by-product of the increased national level of knowledge, the potential for transfer of technology will increase since the rise in knowledge may enhance the competitiveness of local firms and, thus, make foreign investors transfer more advanced technology.

Incentives of information character may also arise from the relative degree of bureaucracy. To attract inward investment, governmental information releases are improved in terms of quality, transparency and reliability. Another dimension of the same incentive belongs to the group of miscellaneous entry and procedural rules and concerns attracting foreign investment by offering a neat and quick way of entry.

A *conscious* strategy of a government to invest and develop a certain sector of its economy leads to the fact that the local expansion of a sector sows the seeds for further growth by increasing the supply of the factors that made the location attractive at the first place (Head et al. 1995). As described by Baldwin and Krugman (2001), "With

agglomerative forces operating, perfectly mobile capital becomes a quasi-fixed factor and investment is not indifferent to location in equilibrium". In this case, favourable economic conditions emerge for investments. For example, advantages are presented by an established infrastructure, accumulated experience, established customer and supplier base and well-financed workforce. This is consistent with internationalisation theories that the stock of FDI in a certain location predicts and explains the attractiveness of that location for further investments (Buckley 1996; Ghauri and Buckley 1999a). The contribution from the elements of the race should be seen and evaluated in combination with this. Because of the agglomeration advantages, MNEs will be highly attracted to the particular location and even zero tax rates in a location without these advantages might not attract FDI, particularly in that specific sector, unless the cost of investing in the particular location rises beyond the advantages of agglomeration. Ireland is a good example: it attracted FDI not only through tax competition but also by concentrating on agglomeration advantages for two specific industries, electronics and pharmaceuticals.

The need and propensity to use the elements of the race may differ for economies of similar character but with different geographical location. According to Baldwin and Krugman (2001), EU can be divided into two parts due to these agglomeration effects: An advanced 'core' that benefits from agglomeration economies and a 'periphery' that does not. This division has been associated with specific countries; Benelux, France, Germany, and Italy are associated with the 'core', and Greece, Portugal, Spain and Ireland with the 'periphery'. Baldwin and Krugman concluded that the states associated with the 'core' were able to retain investments even while levying higher tax rates than

countries associated with the ‘periphery.’ Hence, agglomeration effects may strongly interact with incentives in the other categories.

4.2 Subsides and tax packages

The second group of incentives for attracting inward FDI consists of different kinds of subsidies. Again, some of the incentives in this category may be seen as inherent, at least in a phase of transition, or rather inherited from the pre-integration period. These are common in political economies (like the Nordic countries) that are characterized by a high political involvement and a high average tax burden (as percent of GDP), implying that all the citizens carry a bulk of social costs. Hence, by directing investment to such countries the corporation may get free access to the infrastructure, while an investment in other countries may be connected with high fees for the use of high ways, telecommunications, etc. Governments in marketing campaigns to attract inward investments can use incentives that are inherent. However, they can also choose to create incentives by subsidizing improvements of infrastructure. Among the traditional subsidies we may identify the following five categories: a) grants; b) tax concessions; c) soft loans d) equity participation; and e) warranties.

Subsidies are generally seen to be incompatible with “free competition under equal conditions”. Forces are working to eliminate these in an integrated world via negotiations and international transparency of trade and investment conditions. However, they are still there at the beginning of the millennium. Here, we would have liked to see the use of subsidies reported in a way that makes it possible for us to sort out how much of the incentives that have been geared to attract inward FDI. But as was stressed before, due to

the unavailability of data we have to resort to the overall use of incentives in this group as an indicator of a government's propensity to use incentive schemes. Table 2 helps us to understand the extent of incentives given by different governments in some industries.

INSERT TABLE 2

As seen from the table the race was stiff in the 1990s within the automotive as well as the electronics, chemicals and semiconductors industries. Moreover in 1997, the French government succeeded in attracting Toyota to invest £1 billion in a small car plant in the North of France by the help of a large government subsidy. No figures for the exact amount of the subsidy are available.

The trend indicated above supports the observation that the size of incentives has increased over the last three decades (Thomas, 1996; Oman, 2000). Despite the formal adherence to the principles of "national treatment", the incentives offered at state (South Carolina – BMW, Alabama – Mercedes, etc) and local level in the United States and at the regional and national level (France – Toyota, United Kingdom – Ford, etc) in the EU seem to provide evidence in this regard.

Grants (excluding supranational grants) in its reported form were in the 1980s and beginning of the 1990s the most important components of total subsidization used by the EU and EFTA countries (Austria, Germany, Iceland and Portugal are exceptions). They were particularly used to subsidize capital formation. Table 3 shows grants that were used by most EU member states in the early 2000.

INSERT TABLE 3

Subsidies are used very differently in the OECD-countries. However, most of them are used for sub-sector specific purposes. The EU-average for 1986-88 (excluding supranational support) for sub-sector-specific purposes was 65.4 percent of total industrial subsidies, based on figures from CEC (1990). The region specific support came second amounting to 15.6 percent. The average for the EFTA countries (SITC 2 and 3) for 1984-1987 was 42 percent. Region specific and other general support came next, totalling about 20 percent each (see EFTA 1988). Switzerland exhibits the highest figure of all ECX and EFTA countries for Research and Development subsidies (33.9 percent of total industrial subsidies) Denmark is at the top when it comes to environmental subsidies (5.8 percent), while the Netherlands is the country that devotes the largest share of subsidies to small and medium-sized enterprises.

Tax concessions are tax-code provisions that favour some sectors or economic activities, such as capital formation, over others. Although international comparisons are of limited value in this context due to incommensurability of data, the relative use of this form of subsidy is known to have been relatively high in the United States and in Germany. The relevance of taxation politics to location decision process of MNEs has fuelled a great debate. Those in favour claim that it encourages operational efficiencies by constraining excess and ensuring government policies that are responsive to citizens' preferences (Ellis 1999). They also argue that competition provides the most efficient means to the end of harmonisation of tax rates and provisions. Those against tax competition argue that tax competition results in economic distortions in the locations of FDI and deterioration of the welfare state (Hendricks 2000).

The EU Code of Conduct on Business Taxation emphasizes tax coordination (EU-COM 1997, p. 564), while earlier reports (The Ruding Report 1992) recommended harmonisation of tax systems within the EU. The principal assumption underlying the Code is that the competitive tax position of all countries is equal. This clearly ignores the fact that there is great disparity among Member States, both on economic and on geographical level. Moreover, without some form of tax-coordination within the EU, there may also be a destructive tax competition, a ‘race to the bottom’, that would undermine the long-term sustainability of Europe’s welfare structures. However, we need to ask whether it is only the ‘race to the bottom’ that creates benefits for countries (as attractive locations for FDI) or whether it is the agglomerative factors.

Consider the case of Ireland: Since 1950’s Ireland has adopted a policy of attracting FDI through tax incentives. Until 1982 Ireland granted a full tax holiday to all new sales made by a foreign manufacturing company. Since 1982 however, companies have been entitled to an automatic preferential corporate tax rate of 10% on all manufacturing profits, regardless of the location where these profits have been generated. Profits derived from manufacturing and qualifying services enjoyed a rate of 10% until the end of 2002. Thereafter, Ireland has agreed with EU commission for a corporate tax rate of 12.5% to apply to all trading activities (Agreement reached July 22, 1998). The special tax rate (10%) has been widely recognized as one of the main factors inducing MNEs to locate in Ireland (O’Malley 2000; O’Connor 2001).

Soft loans comprise loans from the government to the private sector at terms more favourable than those obtained on the open market. The use of this form of subsidy has been relatively high in, e.g. Denmark, France and Japan. In Japan most soft loans have

been offered to small and medium sized firms. Table 3 shows that the use of loans as investment incentive is very common.

Government *equity participation* involves subsidy to the extent that the rate of return demanded by the government falls below that demanded by private capital markets. Among the EU and EFTA countries, the relative use of this form of subsidy was in the 1980s by far the highest in Austria (See CEC, 1990; EFTA 1986, 1987 and 1998 and Ford and Syker, 1990). The use of this form of incentive can easily be disguised within the (pretended) frame of a joint venture.

Government may also offer *guarantees/warrantees* on loans as a form of subsidy. This has particularly been the case in Iceland, France and Sweden. Incentives contributing to a lower cost of capital of the potential investor will work as a trigger for FDI as pointed out in an OLI-framework by Oxelheim et al (2001). To the extent that the lowering is conditioned upon a subsidy or other cost-reducing incentives from a particular country the case for inward investment to that particular country is improved.

4.3 Looser interpretations of international agreements

Here we find two kinds of policies aimed at reducing the production costs by the lowering of requirements put on the producing firms. One of these is the lowering of the requirements put on the labour environment. This phenomenon is often called *social dumping*. The case often referred to here is the move of Hoover (the producer of vacuum cleaners) from France to Scotland. Moreover, some may argue that this is not a result of governmental policies but rather of labour union policies.

Governments may have intentionally invested in skilled labour in abundance. Such an investment will later provide the government with more room for manoeuvring in the race. The higher the skill of the labour the bigger is the room for looser interpretations of international agreements. There is thus a readily/easily accessible common labour pool for existing and potential newcomer firms in the market. Attraction of India (Bangalore) as a host for FDI in software is a good example of these conditions. The second alternative is the lowering of the bar for the environment responsibility of the firm. This phenomenon, which is called *environmental dumping*, may with the enlargement of EU also appear as new EU countries do not increase the corporate environmental responsibility fast enough.

4.4 Cyclical and geographical factors

The fourth kind of incentives include inherent geographical advantages such as differences in business cycles and seasonal patterns, and other such differences that will remain even as integration becomes more or less perfect. In terms of the race, these factors may be benign. The availability of up-to-date infrastructure is a major factor that attracts FDI to a market. A number of authors have studied this phenomenon to explain why certain markets become primary choice for FDI projects by MNEs (see e. g. Dunning 1986; Morris 1988; Buckley and Ghauri 1999b, Oxelheim 1985; Ghauri et.al. 2004). Most of these studies report that MNEs invest in markets that have an up-to-date infrastructure as regards transportation and communication. The incentives in this group are mostly inherited and need to be marketed in order to become true drivers of inward investment. Finland, as a country in the periphery of EU, may attract inward investment

by translating its geographical position into something positive like “the gate to Eastern Europe”. Similarly, deviations in terms of business cycles and seasons may be translated into incentives.

4.5 Nationalism and home country biased consumer

Finally, the fifth group contains incentives that work via some kind of support to home-country biased consumption that may be inherent or created. These incentives provide a soft alternative to traditional trade-barriers. Instead of imposing a tax on import, consumption of goods and services produced domestically are subsidised. One way of doing this, which requires no outright payments from the government, is to play on nationalistic feelings. This incentive or stick has been used for years but often for capital account reasons. The former Russian president Boris Jeltsin urged the Russian people to buy goods produced in Russia. For a foreign producer of goods aimed for the Russian market this transformed into an incentive to move production to Russia in order to get access to the Russian market. The stick will of course only bite on companies that are keen to get access to a very big market or to a market of great importance to the company’s profitability. In the United States, “made-in-Amerika” or “made-in-the-USA” campaigns are good examples of national campaigns that forced Japanese automobile firms to invest in the U.S.

6. THE COST AND BENEFITS OF ATTRACTING FDI

The world-wide stock of inward FDI increased in current prices from USD 734 billions in 1982 to USD 8895 billions in 2004 (UNCTAD 2005). What then can a host country do in

order to boost its chances to take part of this growth? The question leads to two sub-questions: What constitutes a successful policy in an integrated world? Appropriate liberalization policies appear to be a necessary precondition for attracting FDI. However, changes in the economic and market conditions are also necessary. What may tip the opinion in favor of a particular host country is the addition by the government of that country of an incremental flavor to boost the attractiveness. The stronger that flavor is the closer to the border between “fair” and “unfair” competition policy comes. Some measures undertaken may also mean that the government passes the “grey” area into the area of truly “unfair” measures. The second question is then: Can anything be achieved by government policies to attract FDI?

The major reasons for welcoming inward FDI at the government level is that FDI brings: 1) spill-over of technology; 2) spill-over of management skills; 3) capital flows with no debt-servicing obligation attached; 4) new domestic jobs; and, finally, 5) additional production capacity. We may here note that the first two benefits, which are often achieved in an agglomeration context, confront governments with a delicate problem.

There is also a cost side of inward FDI for the host country, although most researchers seem to agree that benefits of inward FDI exceed costs (McDermott 1989; Buckley and Ghauri 1999; Oxelheim 1993). A problem in calculating the cost is to evaluate the opportunity cost in terms of the value forgone by using the money on incentives rather than on direct measures to improve productivity, efficiency and knowledge creation. When the estimated value of offered incentives amounts to USD 3.4 million per job created, as shown in Table 2 for the case when in 1996 Dow was attracted to Germany,

this concern seems relevant (Lowendahl 2001). Perhaps there was also a social and/or signal value from the 2000 jobs created as a response to an incentive package amounting to USD 6.8 billion that should be included in the cost benefit analysis to properly understand the logic of German politicians in this particular case. The cost/job when South Carolina managed to attract BMW may to some also seem high. However, ten years later, when the number of jobs has actually increased ten times, the initial cost/job may seem reasonable.

To what extent can positive effects from the use of incentives be expected to accrue to the host country? The answer to this question is not easy and clear-cut. For the company the uncertainty is a matter of the duration of the offer. On the cost side, the company has to be sure that the incentive offered, e.g. a subsidy on interest rate, is not withdrawn prematurely. If so happens, the company may end up with negative returns for the investment and run the risk of being out-competed causing capital waste.

The new type of political risk does not reflect the general behaviour of politicians (Oxelheim 1996), but rather a relative-risk vis-à-vis competitors. Once you know the conditions the government has offered you and invested based on that, you never know what the government offers your competitor or what other countries offer that firm. Hence, though you get a very beneficial package from politicians you may be out-competed by a firm that has received an even better package. The new version of political risk thus becomes a transparency issue.

Within the balanced budget framework, the only constraint on the use of incentives connected to outright costs (in a tax-harmonized world) is the availability of fiscals resources. In the EU-context, the taxation issue is still a national one though there

are forces working on favour of taxation being an issue for the EU (Andersson et al, 2007). However, harmonization efforts are geared only to the tax rate and base. By giving priority to subsidies for attracting inward investment, in the short term, some other tax-financed projects may have to be postponed. In the longer term, however, more resources may become available with the potential expansion of the tax-base that the new inward investments will cause. In an integrated world, access to global savings is free and governments may find it tempting to finance subsidies through loans, making the upper limit of their efforts to attract inward FDI a subtle question.

For governments of host countries, it is of crucial importance that firms that have been targeted and attracted deliver all what is expected from them. If not, it is essential to have contracts stating a repayment of incentives received. Moreover, the host country A's government always runs the risk that some other countries B and C bid for the same kind of investment and offer an even better package to the competitors of the attracted firm. This will render these firms a lower cost of capital and good chances to out-compete the firm attracted by country A. This is part of what is called the race to the top of incentives. However, for the government of a host country there is a risk that a too generous subsidy may signal future problems in the host economy and hence repress rather than attract inward FDI.

From a global or regional welfare point of view, the race is often claimed to have an adverse effect on equilibrium. The incentives may divert production from country A, with the most efficient production conditions, to the less efficient country B. At a first glance, this might leave the region as a loser and the host country B as a winner. However, over a longer period, the production conditions in host country B (who

managed to attract the investment) may improve as a result of the attracted FDI. An efficient production may emerge and offer country A (to the extent it has kept its efficiency intact) stiff competition from which, eventually, the entire region will benefit.

6. THE EU AND WTO – THE REGULATORY FRAMEWORK

In the previous sections we have found evidence of a pending full sized race for inward FDI inside the EU as well as on a global scope. How well is then the existing regulatory body equipped to hinder the race to emerge? In this section we will see what legal forces there currently are at force.

6.1 The EU regulatory framework

As European countries are increasingly becoming “FDI friendly,” they can, based on the historical record be put into three groups according to their eagerness to attract FDI. Group one that has constantly and proactively sought to attract FDI includes UK, Ireland, the Benelux countries and Spain. The second group that was traditionally unwelcoming to FDI and has recently become “FDI friendly” includes France, Portugal, Greece, the Scandinavian countries and the new EU members from Eastern Europe. The third group that is still rather “unfriendly” to attract FDI includes Germany and Italy (Oman 2000).

The EU policies to control state subsidies, or “state-aid,” are spelled out in the original Treaty of Rome in two articles. These articles deal with a general ban on fiscal and financial subsidies to industry as a whole. There is no direct reference to subsidies to attract FDI. There are three basic types of EU rules on government subsidies: rules to

limit “strategic” subsidies to a particular sector, “horizontal” subsidies to small and medium sized enterprises (SMEs), and “assistance” to poorer regions. However, some exceptions have been allowed for “state aid” to SMEs and poorer regions. As a result, governments of EU-member states are not allowed to give any incentives to attract FDI except for projects in “least-favoured” regions. The status of “least-favoured” or “development” regions, however, is to be decided by the EU. To qualify for that, the per-capita GDP has to be no more than 75% of average EU per-capita GDP (Santos 2000, Hendriks 2000, Oman 2000).

For the “least-favoured” regions, governments can provide up to 50% of the value of an investment project’s fixed assets; for the “development areas” the aid is limited to 20% of the value of the project’s fixed assets. If governments want to give “aid,” they have to apply in advance, and it is up to the Commission to decide whether a particular project is eligible for this “aid” or not. This type of development assistance to less-favoured regions has thus been the only financial incentive allowed by the EU to attract FDI. For example, 80% of all “Greenfield” FDI in Ireland received such “aid” (Oman 2000, p. 58).

However, despite these regulations and in addition to what has been previously noted there are signs of increased competition for inward investment in the form of a considerable increase in the number and range of activities of national investment promotion agencies within the EU. A number of these agencies are now opening their offices abroad and are proactively seeking to recruit projects from their neighbouring countries. We have also mentioned in Table 2 a number of inward FDI in the EU where incentives have played a role; such as Hyundai’s 1996 semi-conductor investment in

Scotland, where the British government reportedly paid about \$190,000 per job directly created by the project; Ford-VW's investment in automobile industry in Portugal in 1996 offering 5000 new jobs, which received an investment package of \$265,000 per job; and VW's investment in Lower Saxony to save 2,300 jobs, that reportedly received about \$180,000 per job (Oman 2000, p. 59).

While the fundamental freedoms of the EC Treaty do not distinguish between general and specific tax measures that have discriminating or restrictive effects, this distinction is paramount in the area of State aid law under Article 87 EC (Schön 1999). Article 87 (1) prohibits aid that distorts or threatens to distort competition 'by favouring certain undertakings or the production of certain goods'. Most investment agencies in Europe thus claim that although the competition for FDI is intense, it has not led to bidding wars (Oman 2000, p. 60). In some countries, for example the new EU members, tax concessions have been more important than financial incentives to attract FDI. The danger of tax incentives to attract FDI led the EU council to adopt a code of conduct in December 1997.

6.2 The Code of Conduct

According to the code of conduct, member states agreed not to use 'harmful' tax measures and to roll back existing harmful measures (OECD 1998). Commission also reduced 'less-favoured' regional investment incentives (from 75 per cent to 50 per cent) and 'development areas' incentives (from 30 per cent to 20 per cent). Efforts were also made to increase the coherence between individual governments' aid programme with EU's own regional assistance programme. The Code of Conduct attempts to deal with

situations where ‘potentially harmful’ tax measures are ‘unfairly’ competitive by virtue of ‘a significant effect on the location of business activity’. It follows that where potentially harmful tax measures amount to State aid, a Commission enforcement action against a member state in the European Court of Justice is possible. Despite the fact that the Code is not legally binding, it mentions the possibility of Commission enforcement (Bratton and McCahery 2001).

Under the Code of Conduct, a Member State can continue to take a competitive posture with the introduction of an across-the-board tax reduction that benefits both existing businesses and potential investments. This stance aligns itself with the State aid rules, in that specific tax measures are subject to the rules, whereas general tax measures are not. The Code furthermore permits that Member States should not be restrained from introducing a reduction in business taxes to stimulate the competitiveness of the domestic business environment.

6.3 WTO Rules

The GATT had no FDI issues on its agenda but exclusively trade issues. With the emergence of WTT in 1995 the scenery changed somewhat. WTO requires that member states should make their regulations conform to WTO rules. The subsidies or incentives have to follow the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement). All pre-operational investment incentives are considered subsidies and are prohibited according to SCM. Some subsidies, e.g. “Production Subsidy,” are not prohibited but are “actionable” and are subject to challenge in case they cause adverse effects for the interests of another WTO member. However, WTO only regulates

subsidies in the goods sector and the SCM Agreement is not easily applicable to all kinds of investment incentives, in particular locational incentives (United Nations 2002, p. 209).

As WTO only deals with the granting of incentives in the pre-production period, creates problems in the measurement of adverse effects for other member states. By the time production and trade/export have started, incentives given to attract investment have often ended. Moreover, even if contested, the WTO settlement is not likely to “undo” or change investment that has already been made. Although countervailing duties can be imposed, it can only be done if another member state can determine that there are subsidised imports coming into its market (from that particular investment), that it is harmful for its domestic industry and that there is an established link between the subsidised imports and the “harm.” However, although there is a provision in the SCM Agreement that a state may be asked to withdraw tax holidays given to attract FDI and perceived inconsistent with the provision of SCM Agreement, there is no mention of repayment of subsidies/incentives (WTO/DS126/RW, Article 21.5, 21 January 2002).

7. CONCLUDING REMARKS

In this paper we have outlined the race for inward investment and an adjacent disequilibrium in global production. The logic behind the timing of the race is the levelling of macro policies within the EU and the appearance of new attractive production sites in the developing world like China and India. With all policies more or

less alike in the EU member countries in general and those in the periphery in particular will find themselves tempted to boost the attractiveness of their country for inward FDI. We have shown that many forms of investment incentives exist today despite the efforts by both the EU and the WTO to reduce the importance of these. We argue that, in times of recession in particular, governments will use five categories of incentives to attract inward FDI in order to reduce unemployment, get access to important technology, etc. Two of the categories were found mostly soft or benign from a regional welfare point of view, whereas three of them were found potentially malign to that welfare.

The incentives used in boom times will be predominantly soft: i.e. of quality rather than quantity character aimed at enhancing general productivity of a country by improving, for instance, the quality of its educational system and infrastructure without offending too many of the other member countries. One triggering mechanism for a stiffer race and an at least temporary deviation from global equilibrium is the appearance of China and India on the global map of attractive production sites combined with the need for a restructuring of European industries following the introduction of the euro. In times of recession and asymmetric shocks to particular EU-countries, fuelled by nationalism, the use of “hard” (malign and created) incentives, such as cash-flow related activities, e.g. the offering of grants and loans under favourable conditions, is likely to increase and stiffen the race. The worst-case scenario is that the race becomes so strong that it makes a threat to the cohesion of the entire EU.

On a global scale, as well, first there is an increasing shift of FDI from developed countries of Europe and North America towards emerging markets of Asia and second there is a palpable threat that the use of incentives conflicting with the tradition of “fair”

competition will be too extensive and lead to trade and investment wars. The major threats are those incentives that are created by governments and that have no benchmark positions. In case of a race in its most extensive form the risk is obvious that governments of many nations will re-impose capital controls and trigger a general wave of re-regulation making the global welfare take a giant leap backwards. To prevent this scenario from coming true, the creation of a strong supranational institution with the task of supervising competition with regard to FDI as well as trade and equipped with enforcement power (a strong WTO?) has to be given highest priority among EU as well as global policymakers.

The challenge to researchers is that it is becoming hard to model the determinants of the FDI flows without paying any attention to the incentives of the race as put forward in this paper. Hence these elements – seen as a combination of O and L in the OLI framework need to be revised. When it comes to the empirical testing the unwillingness of companies as well as of governments to supply data will constitute a barrier to a full understanding of the cross border investment process.

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Table 1 Contracted and Realised Investment from European Union into China 1990-2005

Year	No. of Projects		Contracted FDI Value		Realized FDI Value	
	E.U.	National Total	E.U.	National Total	E.U.	National Total
1990	82	7273	22422	659611	14735	348711
1991	163	12978	75939	1197682	24562	436634
1992	763	48764	96360	5812351	24297	1100751
1993	1726	83437	318176	11143566	67124	2751495
1994	1464	47549	562958	8267977	153769	3376650
1995	1582	37011	741977	9128153	213131	3752053
1996	1167	24556	675922	7327642	273706	4172552
1997	1040	21001	422882	5100353	417115	4525704
1998	1002	19799	593938	5210205	397869	4546275
1999	894	16918	409566	4122302	447906	4031871
2000	1130	22347	885516	6237952	447946	4071481
2001	1214	26140	515284	6919455	418270	4687759
2002	1486	34171	450693	8276833	370982	5274286
2003	2074	41081	585432	11506969	393031	5350467
2004	2423	43664	836189	15347895	423904	6062998
2005	2846	44019	1153071	18906398	519378	7240569

Origin: MOFCOM FDI statistics

Table 2 Estimated incentives for automotive, electronics, chemicals and semiconductor FDI projects – Inward FDI (selective) in the US and the EU member states, 1980-2000.

Date of package	Country of project	Investor	Amount per job (US\$)	New jobs/investment
Automotive – USA				
1980	United States	Honda	4,000	
1983	United States	Nissan	17,000	1,300 jobs
1983	United States	Mazda-Ford	14,000	3,500 jobs
1985	United States	GM Saturn	27,000	3,000 jobs
1985	United States	Mitsubishi-Chrysler	35,000	2,900 jobs
1985	United States	Toyota	50,000	3,000 jobs
1986	United States	Fuji-Isuzu	51,000	1,700 jobs
1993	United States	Mercedes-Benz	170,000	1,500 jobs/US\$300m
1994	United States	BMW	79,000	1,900 jobs/US\$800m
1997	United States	DaimlerChrysler	100,000	3,500 jobs/US\$750m
1998	United States	Toyota	69,000	2,300 jobs/US\$1.2bn
1999	United States	General Motors	60,000	3,800 jobs/US\$500m
2000	United States	Honda	105,000	1,500 jobs/US\$400m
Automotive – Other				
1985	United Kingdom	Nissan	54,000	2,700 jobs
1992	Portugal	Ford-Volkswagen	255,000	1,900 jobs/US\$484m
1993	Hungary	GM	300,000	213 jobs/US\$64m
1997	Germany	Volkswagen	180,000	2,300 jobs
1998	United Kingdom	Ford	138,000	500 jobs
Electronics, chemicals and semiconductors				
1993	United States	Intel	120,000	2,400 jobs
1994	United Kingdom	Samsung	30,000	3,000 jobs/US\$89m
1995	United Kingdom	Dupont	201,000	100 jobs, US\$128m
1995	United Kingdom	IMR	63,400	>0 jobs/US\$3.17m
1995	United Kingdom	Siemens	51,000-190,000	1,500 jobs/US\$1.1bn
1996	United Kingdom	Hyundai	190,000	
1996	United Kingdom	LG	48,000	6,100 jobs/US\$320m
1996	Germany	Dow	3,400,000	2,000 jobs/US\$6.8m
1997	United States	Shintech	500,000	250 jobs/US\$125m

Source: Compiled from; UNCTAD 1995), Moran (1999), Oman (2000) and Loewendahl, (2001) .

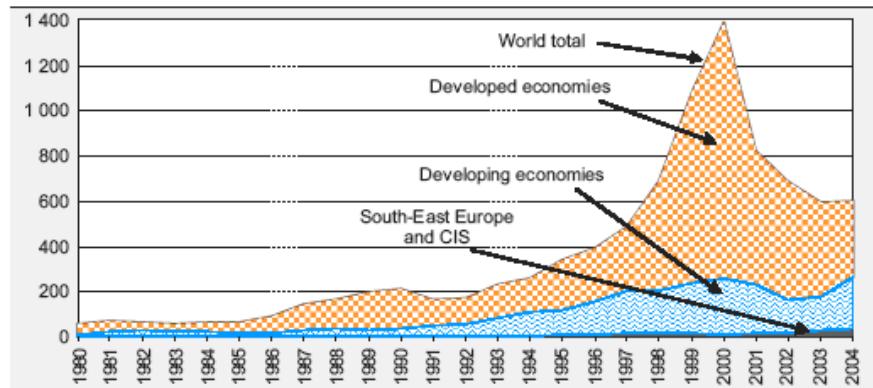
Table 3 FDI Business Incentives in the EU in 2000

	Investment Capital		Regional Development			Job Creation		Corporation Tax Incentive	Labour Costs Tax Incentive
	Grant	Loans	Grant	Loans	Tax	Grant	Tax		
Austria		•	•			•			
Belgium	•		•	•	R				
Denmark		•	•			•			R
Finland	•	•			R				
France	•		•			•	D	R	R
Germany	•	•	•	•	D				
Greece	•	•	•	•		•			
Ireland	•		•		D	•		R	
Italy		•	•	•	D	•	D		R
Luxembourg			•					R	
Netherlands			•			•			
Portugal	•	•	•	•			E	E	R
Spain			•	•	R			R	R
Sweden			•	•		•		R	R
UK	•	•	•	•		•			
New Members									
Cyprus								R	
Czech Republic	•	•	•			•		E	
Estonia									
Hungary	•		•		R	•		E	
Latvia								R	
Lithuania									
Malta		•						E	
Poland									
Slovak Republic								E	
Slovenia			•					R	

Source: Compiled from; EUBIR (2001) *The European Union Business Incentives Report*, 7 (1), Inward Investment Europe, pp. 9-14.

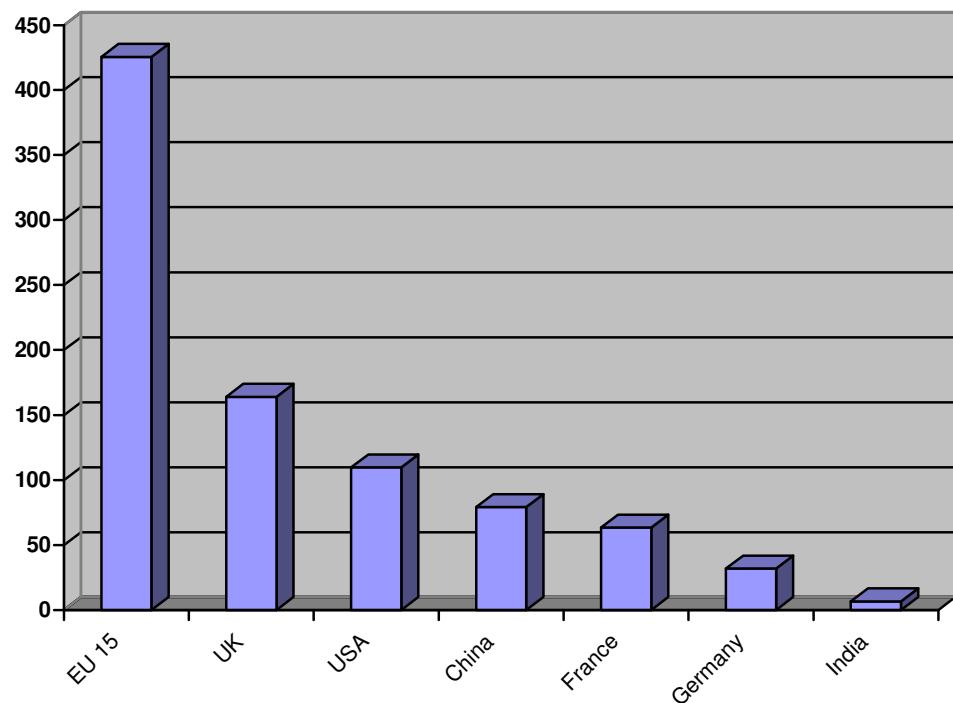
Notes: D – Tax deductible; E- Exemption; R- Reduced rate.

Figure 1 FDI Inflow, global and by groups of economies, 1980-2004 (Billions of dollars)



Source: UNCTAD, FDI/ TNC database (www.unctad.org/fdistatistics)

Figure 2 World FDI inflows, US\$ Bn, 2005



Source: The Economist Intelligence Unit, 2006