

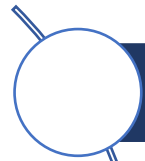
# CORPORATE TAX INCENTIVES TO ATTRACT FDI IN DEVELOPING ECONOMIES

**June 24, 2021**

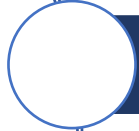
**CEP-GLOBTAXGOV Seminar**

**Hania Kronfol, Private Sector Specialist**

# Agenda



**Key frameworks and concepts**



**Role of tax incentives in influencing FDI**

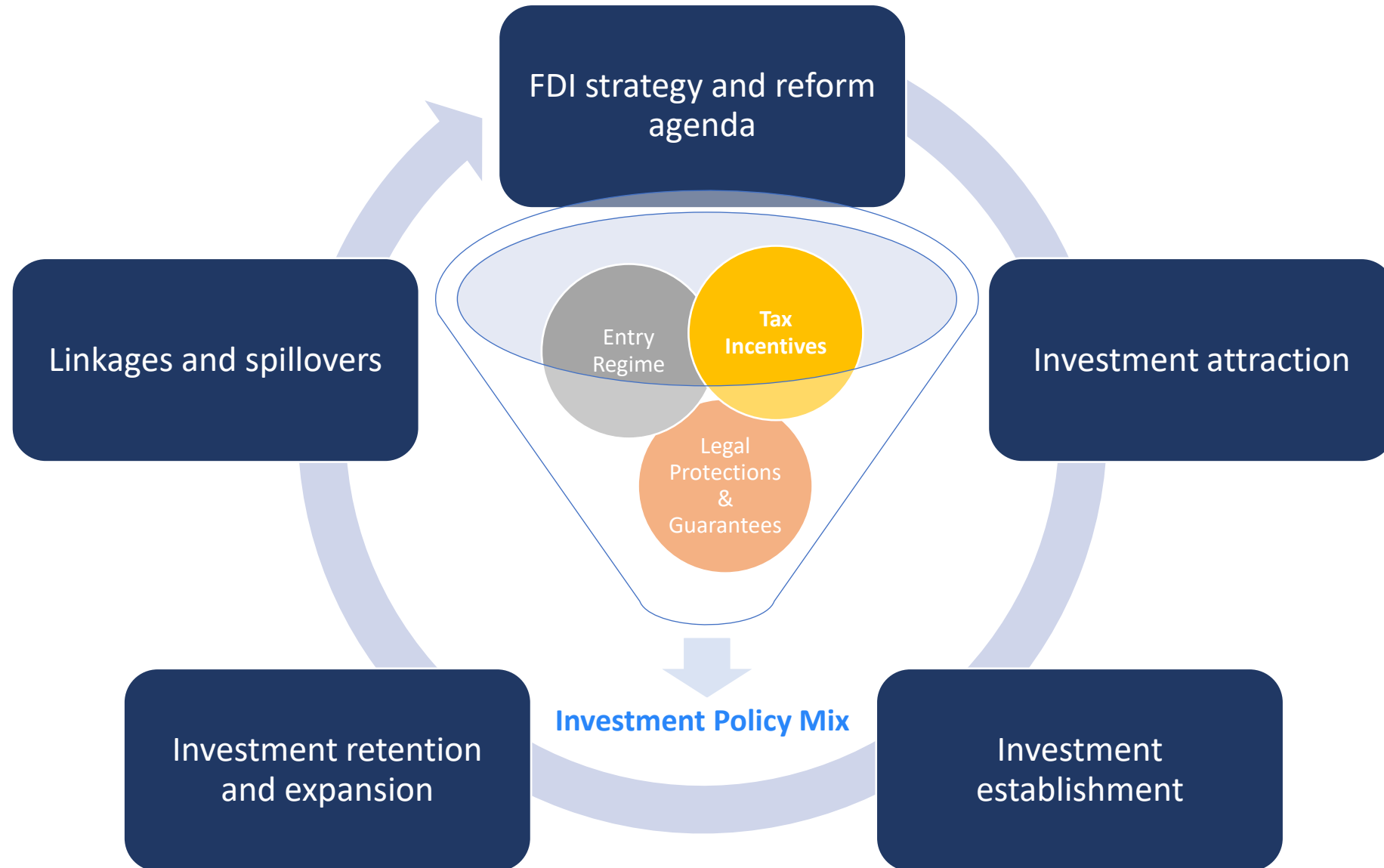


**International Good Practices: Design and administration of incentives to attract FDI**



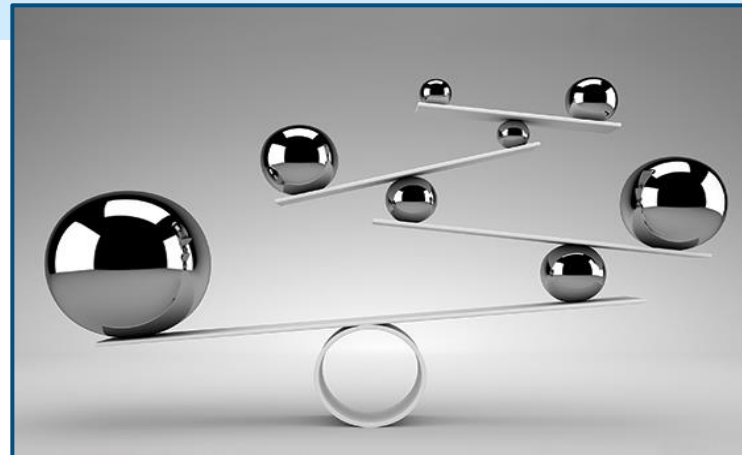
**Emerging policy questions and recommendations**

# Investment incentives are only one aspect of country's broader FDI policy and promotion framework

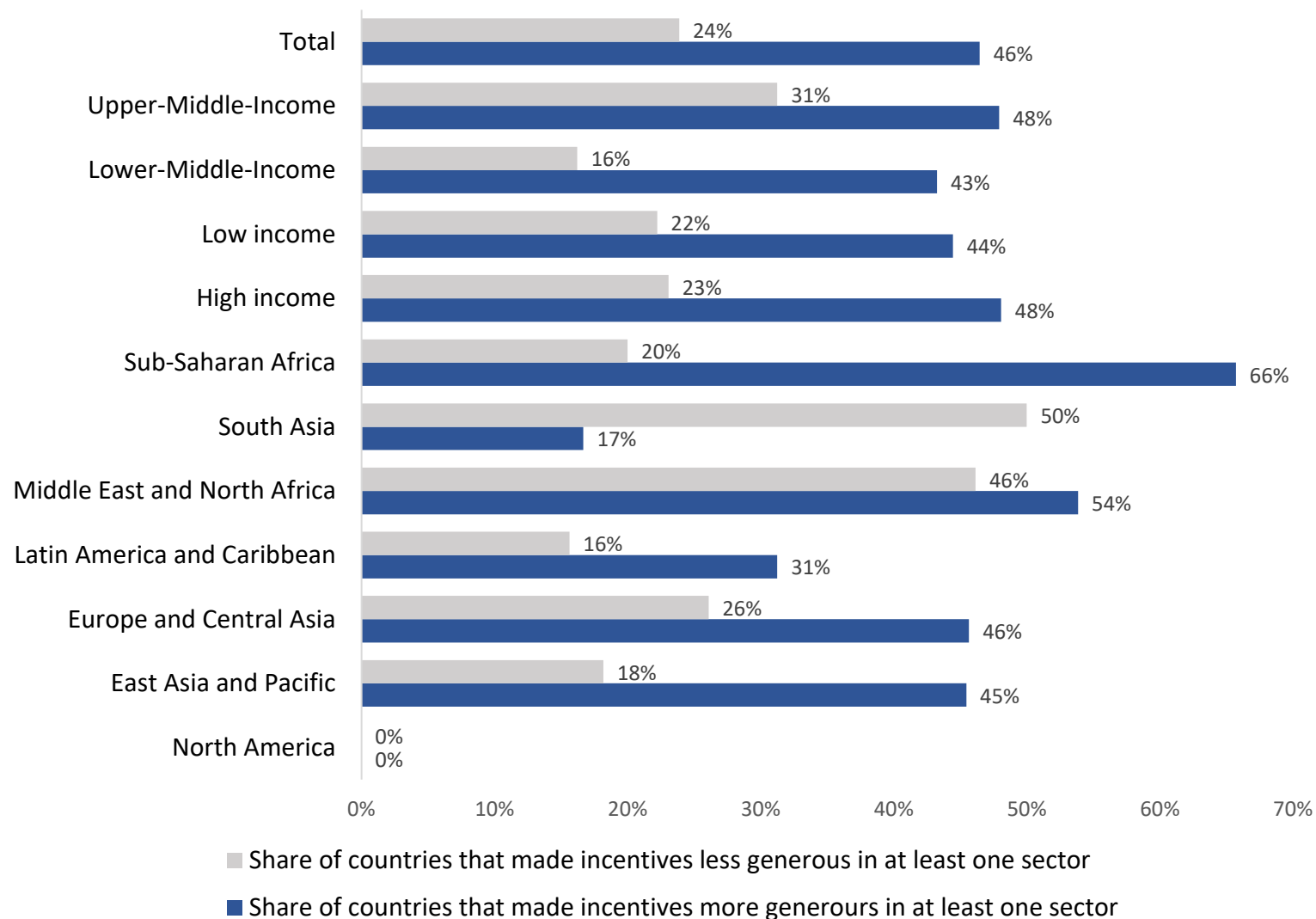


# The advent of Covid-19 highlights four key policy dilemmas underscoring tax incentives policy

1. **securing domestic revenue | promoting private sector recovery and growth**
2. **providing short-term relief to businesses | ensuring long-term fiscal sustainability**
3. **competing on cost savings | advancing different policy agendas (environment, social equity)**
4. **undertaking unilateral reforms | supporting multilateral cooperation**



# Countries increasingly rely on investment incentives to attract investors and influence their activities



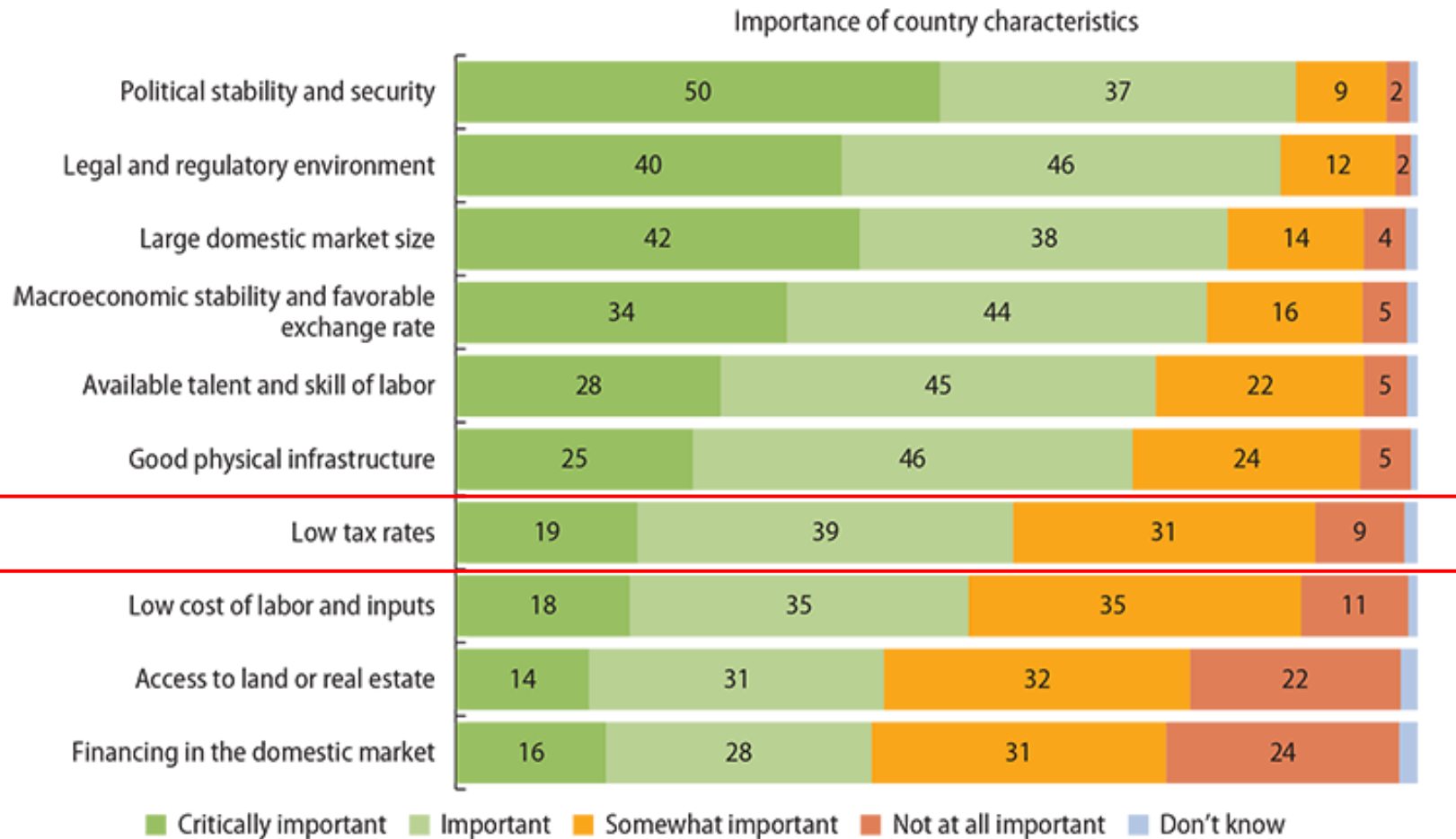
➤ *Between 2009 and 2015, out of 155 countries, 46 percent adopted new tax incentives or made existing incentives more generous.*

➤ *As of 2015, out of 107 developing countries, more than half were granting tax holidays or preferential corporate tax rates across sectors at the national level.*

Note: 155 countries (103 developing countries and 52 high-income, for 2009-15).

Source: Calculation based on data from Anderson, Kett, and von Uexkull, 2018, "[Corporate Tax Incentives and FDI in Developing Countries](#)," in Global Investment Competitiveness Report 2017/2018: Foreign Investor Perspectives and Policy Implications, World Bank.

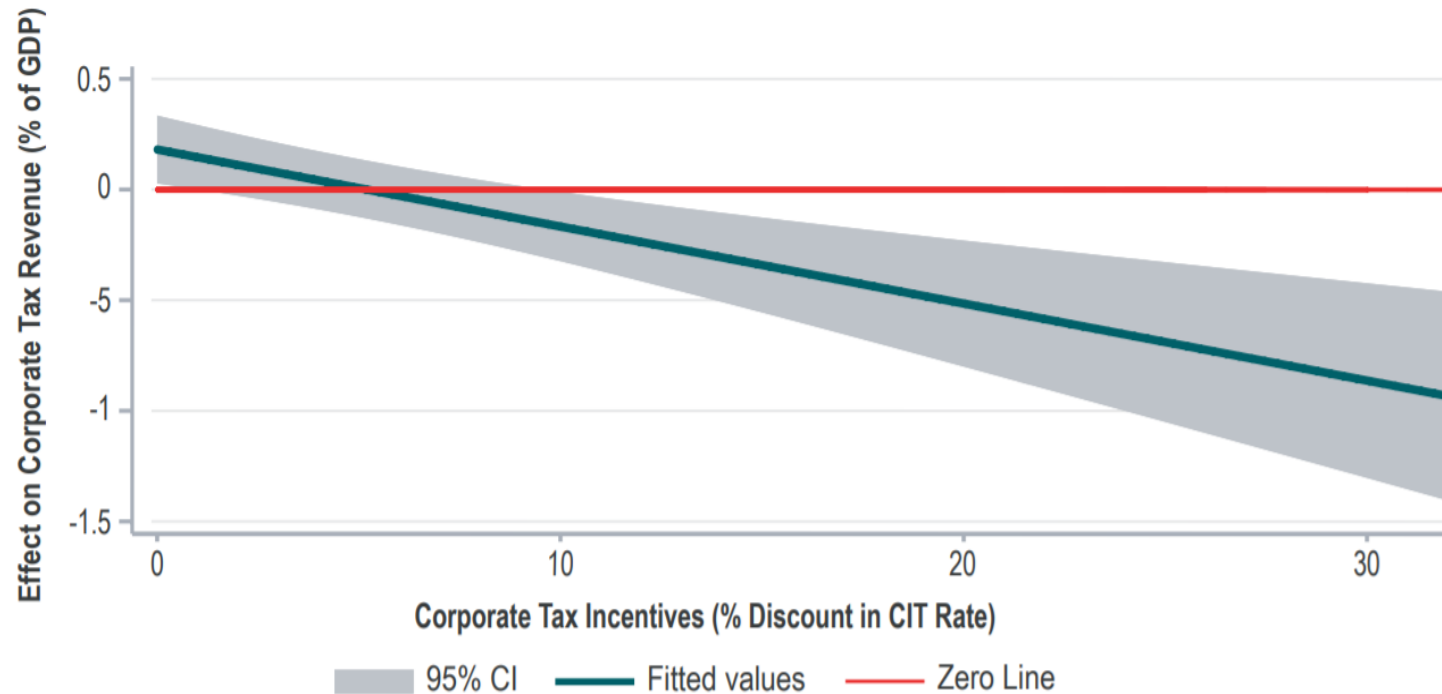
# While the use of incentives is widespread, they play a limited role in investor decision-making



- *In terms of investment location decisions, political stability and security along with a stable legal and regulatory environment are the leading country characteristics considered by investors.*
- *Incentives are second-order considerations that come to bear at the tail-end of the decision process, when investors are wavering between similar locations.*

Source: World Bank, 2018, [Global Investment Competitiveness Report 2017/2018: Foreign Investor Perspectives and Policy Implications](#).

# More generous tax incentives are associated with lower corporate tax revenue



Note: Authors' calculations based on data from Anderson, Kett, and von Uexkull, and WDI, covering 109 countries (72 developing and 37 high-income, for 2009-15).

Source: Kronfol, Hania; Steenbergen, Victor, 2020, "[Evaluating the Costs and Benefits of Corporate Tax Incentives: Methodological Approaches and Policy Considerations](#)," In Focus, World Bank.

- *Foregone tax revenue (tax expenditures) from the reduction in firms' tax liability can impose significant fiscal costs on governments.*
- *Costs of incentives are most burdensome for lower income countries, which are already struggling with revenue mobilization.*
- *At the international level, there is a strong, negative relationship between the generosity of a country's corporate tax incentives and their corporate tax revenue as a share of GDP.*

# To be cost-effective, tax incentives need to be strategically designed and implemented



- Is the incentive conceived to address specific & measurable policy goals?
- Is the incentive best-suited to address the market failure/obstacle?
- Have alternative policy instruments been considered, weighing the advantages, challenges and risks?

- Is the eligibility criteria tied to the specific policy goal?
- It is targeting those investors likely to be swayed by the incentives?
- Is the eligibility criteria objective and conceived to minimize distortions to competition?

- Is the incentive profit- or cost/performance-based?
- Do the analytics and evidence demonstrate that the benefits outweigh the costs?

- Are incentivised firms subject to frequent review and rigorous monitoring?

- Are there effective safeguards in place to prevent abuses through shifting of incentives?
- Does the incentive incorporate a sunset-clause?



# Policy discourse on imposition a global minimum corporate tax rate raises new questions on the role of incentives in driving FDI

- How will the minimum tax influence FDI location decisions for countries at different income levels, with different economic structures, and different attraction strategies?
- How will the modality of FDI corporate taxation evolve? What are the implications for tax competition if higher-income countries are able to leverage direct subsidies to compensate? Will there be a shift to incentives focused on property taxes and social security contributions? Could we potentially see a shift to non-tax platforms to other features of the country's investment climate to attract FDI?
- What will be the impact on SEZs which are especially widespread in the developing world as a means to attract FDI?
- Does a global minimum tax signal a broader step toward international tax cooperation and harmonization efforts?

# With the spotlight on tax policy, developing countries should prioritize much-needed incentive reforms

*Leverage this period of change and fiscal urgency to:*



## Revisit incentive policy through a holistic, evidence-based approach

- streamline incentives (eliminating redundant instruments), improve targeting, and raise cost-effectiveness

## Improve incentive transparency and administration

- publish tax expenditures, emphasize monitoring and compliance, and capitalize on e-digitalization trends to automate procedures



## Focus incentives on sustainable agendas and public goods

- shift policy discourse to promote a “race-to-the-top,” competing on green initiatives, innovation, and skills

## Re-engage on opportunities for international cooperation

- take steps to share information on incentives, and develop common solutions to address tax evasion and profit-shifting



# THANK YOU

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