

Competitiveness and Investment: Lessons Learned

Frank Flatters
Queen's University, Canada
www.frankflatters.com

Purpose

- To review lessons about attracting investment to enhance global competitiveness

Outline

1. Different Approaches to Attracting Investment
2. A Story
3. Beware of Unintended Consequences
4. Conclusion

Two Approaches

- Special and selective incentives are necessary to overcome our disadvantages
 - *Tax incentives; trade incentives (import duties, export incentives, tariff preferences); preferential pricing of utilities and services; ...*
- We need to deal with the real problems
 - *Identify and tackle the sources of high costs*
 - *Selective incentives might be part of the problem rather than the solution*

Indonesia: A Case Study

- Early 1980s: looming macroeconomic crisis in a poor, highly resource-dependent country
- Abolished all tax incentives
- Identified tariffs, NTBs, customs and ports as major sources of high cost; attacked them in many ways over a sustained time period
- Result: doubled share of ASEAN investment; high growth of incomes and employment; massive poverty reduction

Unintended Effects of Special Incentives (1)

- Protection for some hurts others
- Trade preferences, especially in a relatively small market, can be at best unhelpful unless accompanied by general tariff reductions
- Tax privileges for some mean tax penalties for others
- Costs of incentives are high and non-transparent

Unintended Effects of Special Incentives (2)

- High service and utility costs hurt everyone
- Selective subsidies on utilities prices encourage costly investment diversion
- Special incentives encourage rent-seeking and divert entrepreneurial energies from the task of improving competitiveness
- They divert policy makers attention from the real problems

Unintended Effects of Special Incentives (3)

- Special incentives encourage dependence and are difficult to phase out

Conclusion

- Regional and international experience shows the dangers of relying on special investment incentives and the benefits of dealing more fundamental issues in the underlying business environment – the physical and regulatory infrastructures being discussed elsewhere in this conference