

The Impact of Taxes and Incentives on the Inward Investment Performance of US States

Results of a study by Dr. Henry Loewendahl

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October 2013

- **ICA Incentives** database of over 7,000 foreign and domestic incentives deals in the USA with a total incentives value of \$50 billion from 2010-Sept. 2013. After removing outliers and small sample sizes, the average incentive per job created in US states was \$20,000 over the period
- **fDi Markets** database of over 27,000 FDI and inter-state greenfield investment projects tracked in the USA from 2003-July 2013. These projects have created an estimated 1.2 million new jobs and 5,600+ investment motives have been recorded for these projects
- The **2013 State Business Tax Climate Index** from the Tax Foundation

How important are taxes & incentives in location decision making?

**EVIDENCE FROM OVER 3,000 COMPANIES
INVESTING IN THE USA**

Motives for FDI and inter-state investments in USA

Motive	Projects	% of Projects
Skilled workforce availability	438	33.2%
Proximity to markets or customers	387	29.3%
Regulations or business climate	276	20.9%
IPA or Govt support	273	20.7%
Domestic Market Growth Potential	228	17.3%
Infrastructure and logistics	208	15.8%
Finance Incentives or Taxes or Funding	157	11.9%
Lower Costs	112	8.5%
Attractiveness / Quality of Life	68	5.2%
Industry Cluster / Critical Mass	67	5.1%
Other Motive	208	15.8%

Motives for FDI and inter-state investments in USA

Motive	Projects	% of Projects
Proximity to markets or customers	203	34.3%
Skilled workforce availability	189	32%
Regulations or business climate	107	18.1%
Domestic Market Growth Potential	103	17.4%
Infrastructure and logistics	99	16.8%
Industry Cluster / Critical Mass	94	15.9%
Attractiveness / Quality of Life	70	11.8%
IPA or Govt support	63	10.7%
Lower Costs	46	7.8%
Finance Incentives or Taxes or Funding	45	7.6%
Other Motive	121	20.5%

Motives for FDI and inter-state investments in USA

Motive	Projects	% of Projects
Skilled workforce availability	175	79.5%
IPA or Govt support	42	19.1%
Attractiveness / Quality of Life	37	16.8%
Regulations or business climate	37	16.8%
Proximity to markets or customers	20	9.1%
Facilities Site or Real Estate	19	8.6%
Domestic Market Growth Potential	17	7.7%
Infrastructure and logistics	16	7.3%
Finance Incentives or Taxes or Funding	14	6.4%
Lower Costs	14	6.4%
Other Motive	34	15.4%

Motives for FDI and inter-state investments in USA

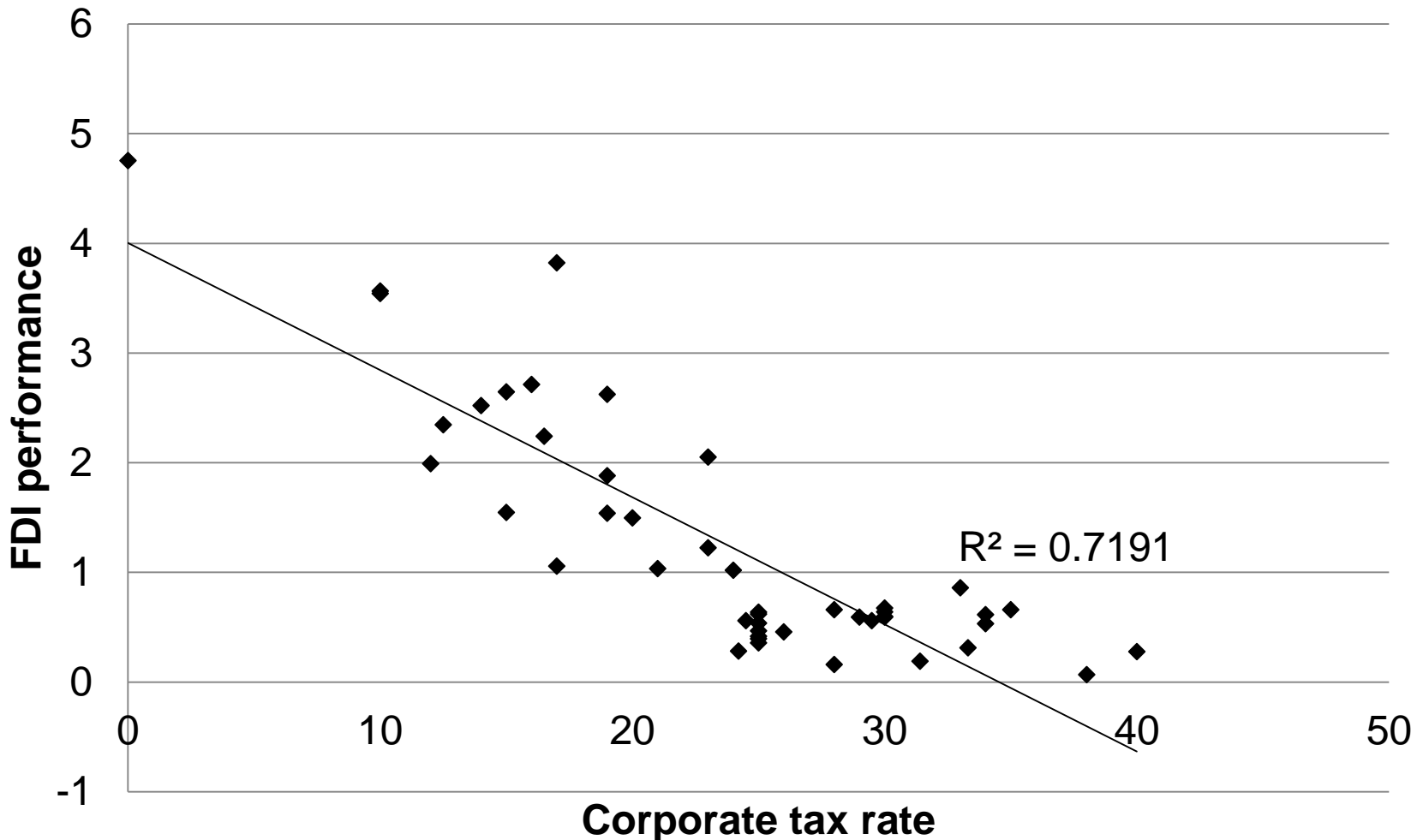
Motive	Projects	% of Projects
Skilled workforce availability	159	50.1%
Proximity to markets or customers	74	23.3%
Industry Cluster / Critical Mass	58	18.3%
Universities or researchers	49	15.4%
Technology or Innovation	35	11%
Regulations or business climate	29	9.1%
Domestic Market Growth Potential	27	8.5%
Attractiveness / Quality of Life	26	8.2%
Presence of Suppliers or JV Partners	21	6.6%
IPA or Govt support	21	6.6%
Other Motive	57	18%

- Overall, taxes & incentives rank the 8th most important location determinant for FDI and inter-state investment in the USA
- Taxes and incentives are most important for Manufacturing projects and least important for R&D projects
- Markets and skills dominate as the most important location determinants
- Over time, incentives have become less important
- Since 2012, Technology & Innovation and Universities/Researchers have become more important than Taxes and Incentives
- Incentives are slightly more important for foreign investment than for domestic investors

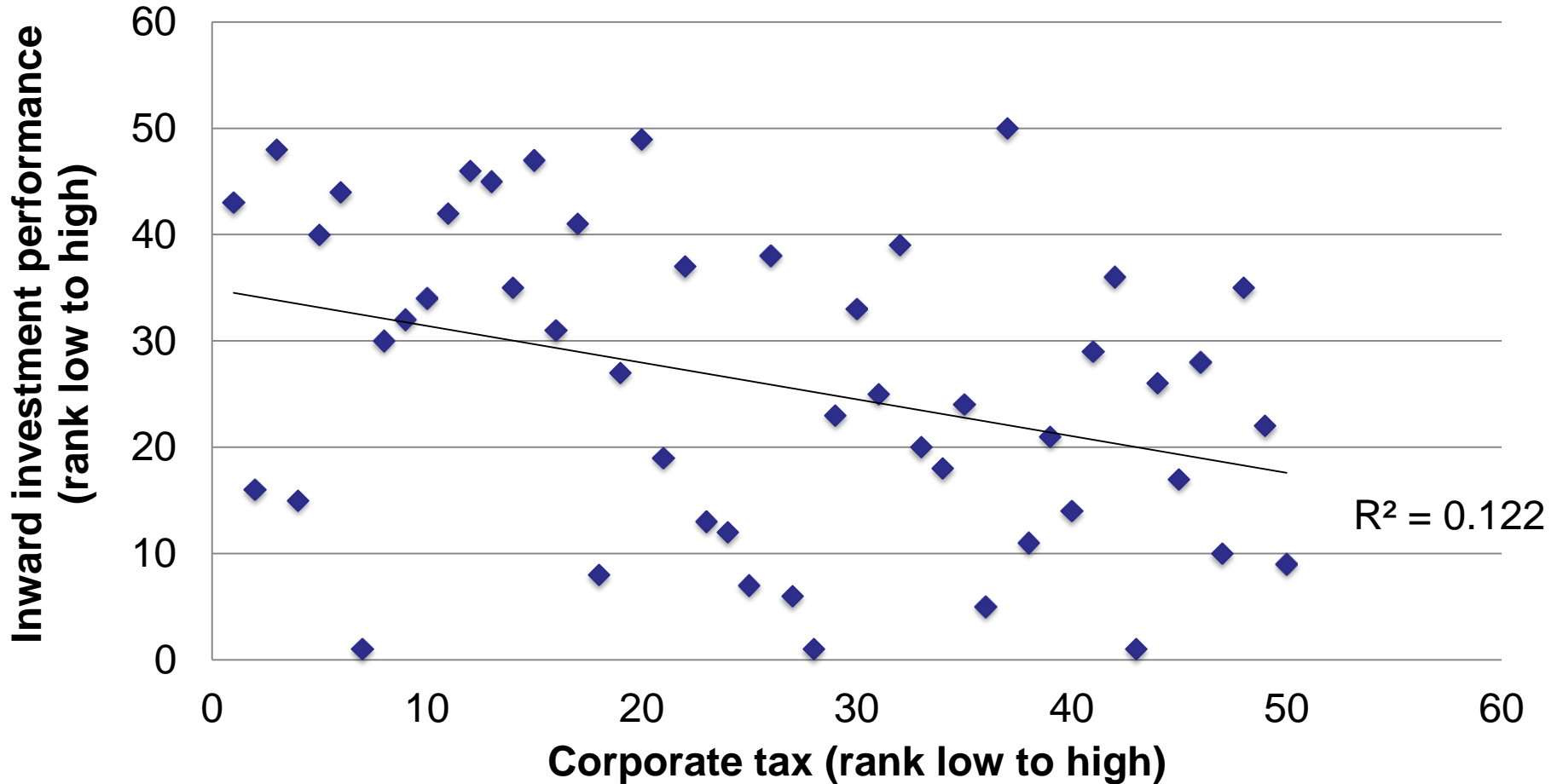
Impact of taxes and incentives on inward investment performance

statistical evidence

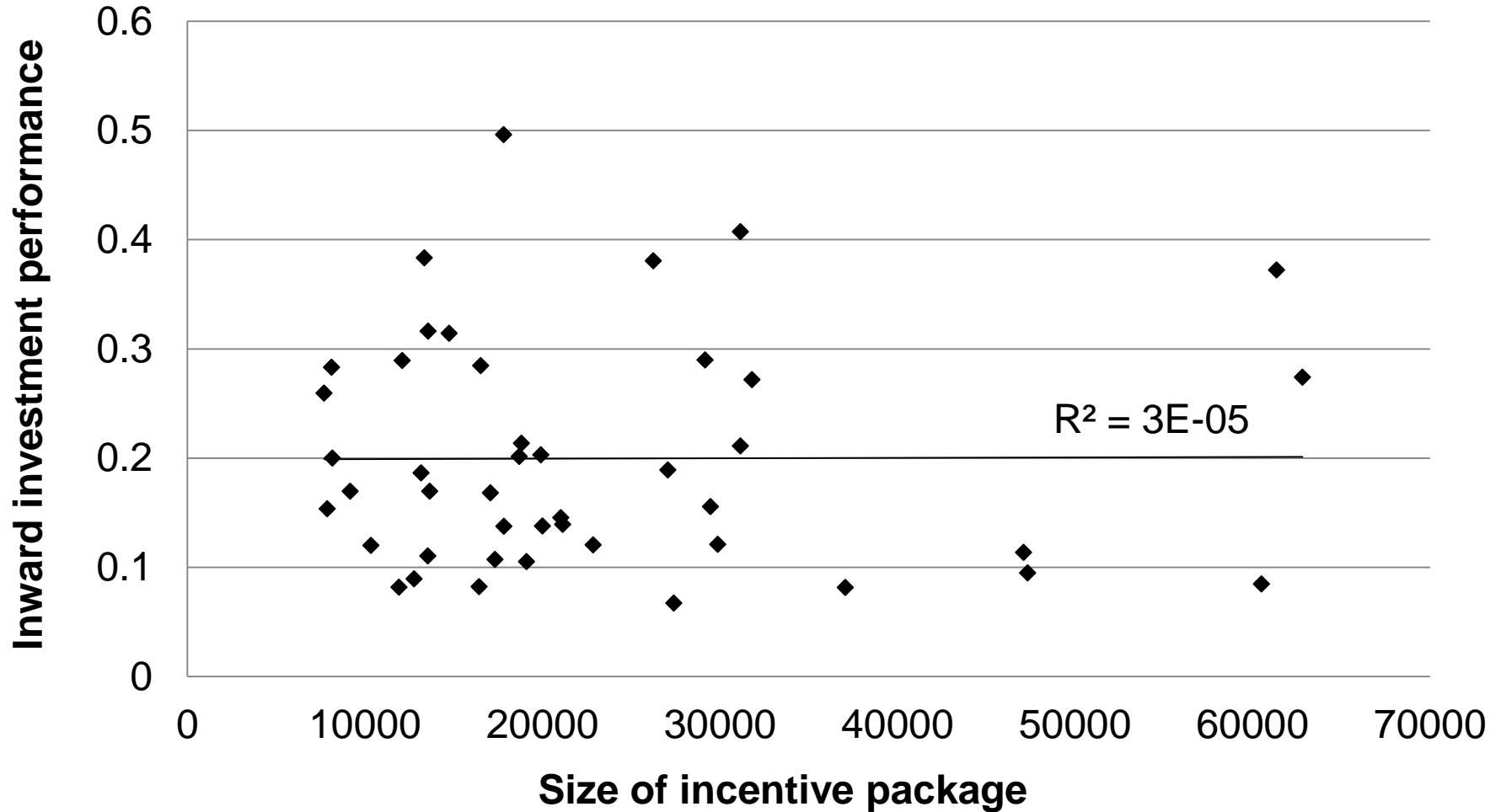
Corporate tax and FDI performance at the country level



Corporate tax and inward investment performance of US states

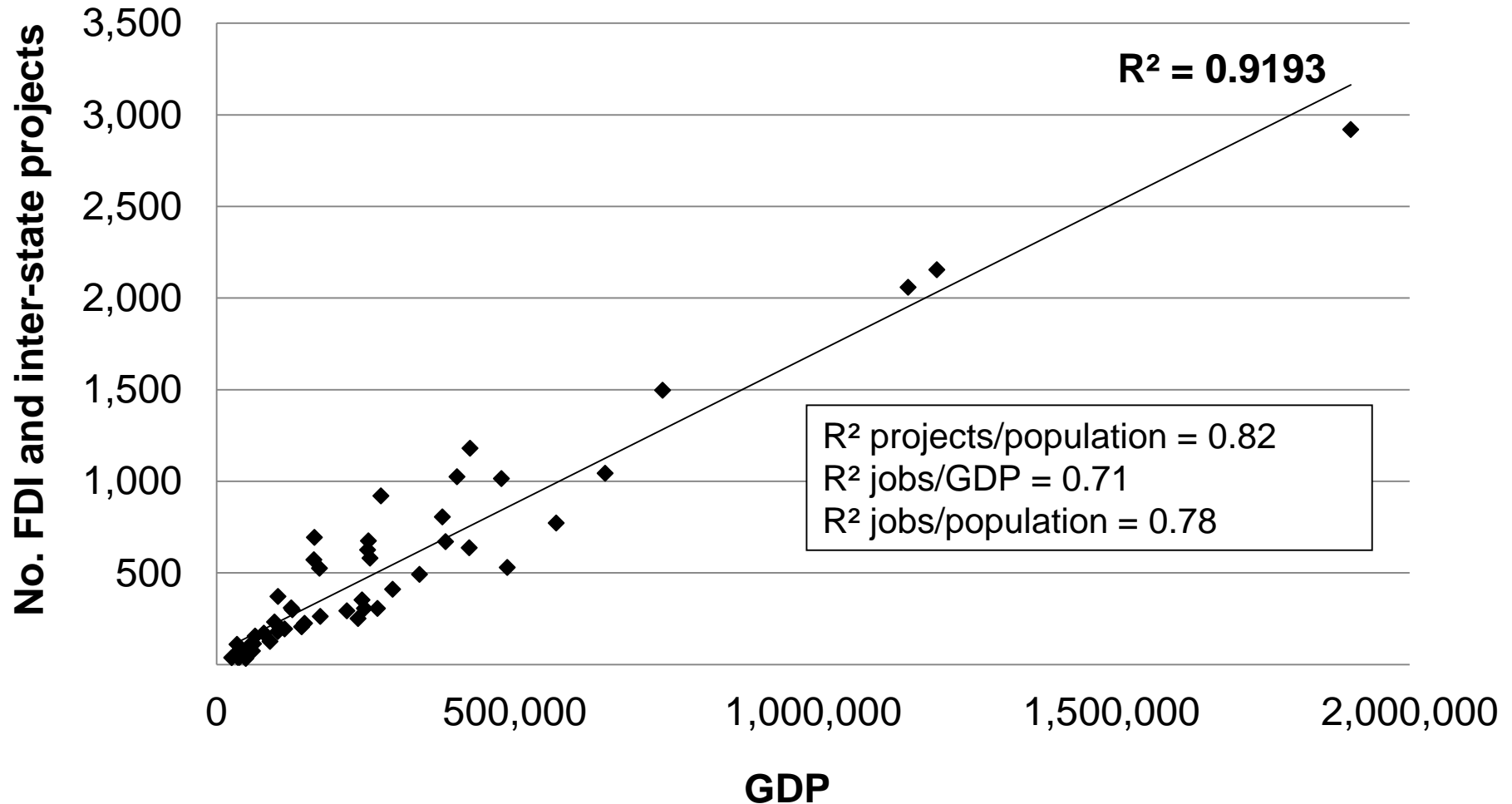


Incentives and inward investment performance

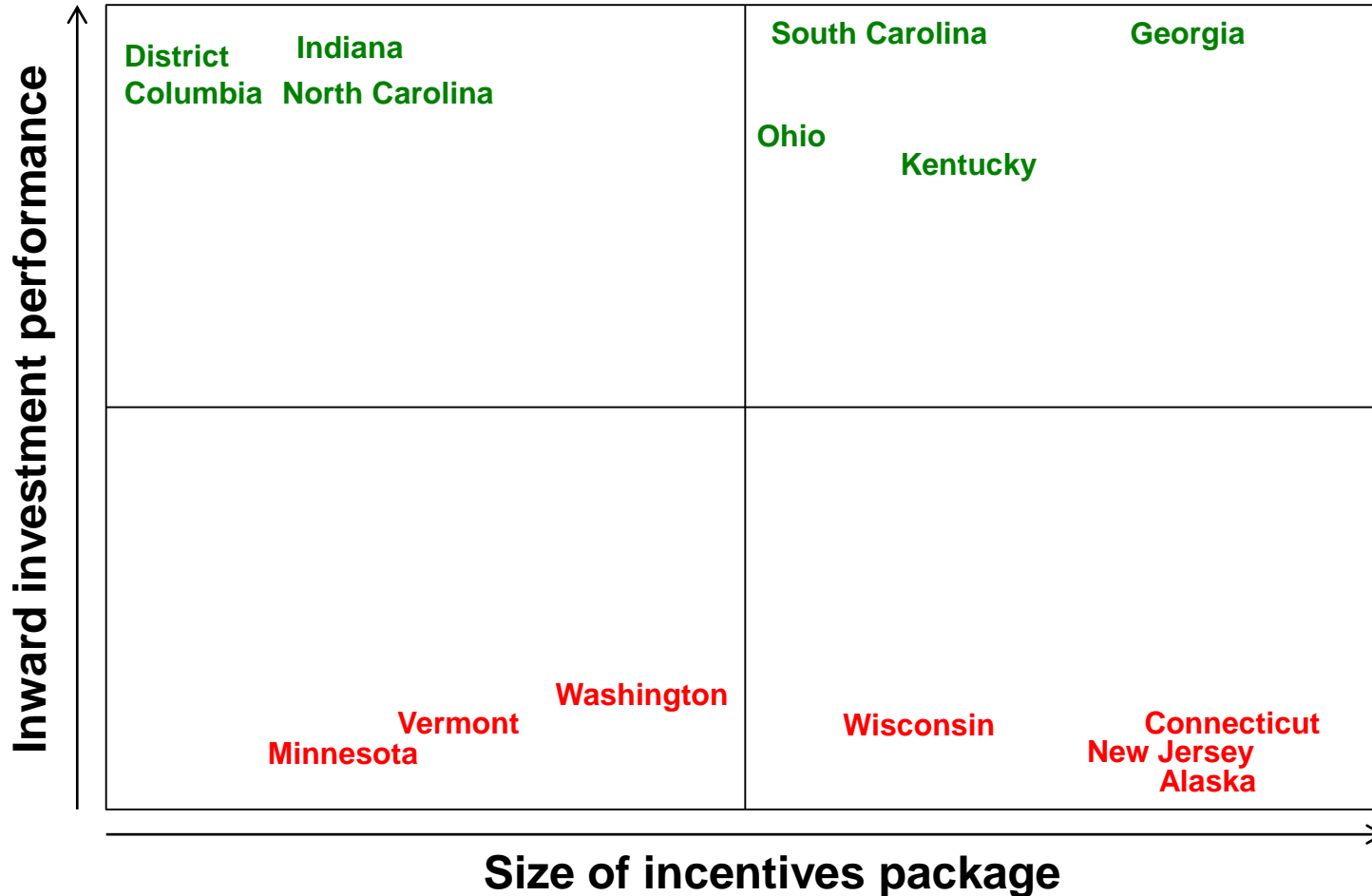


Source: ICA Incentives and fDi Markets. Inward investment performance shows no. of jobs from FDI + Inter-state projects relative to size of GDP (per \$m GDP). Size of incentive package is \$ incentives per job created

Inward investment Projects and GDP of US States



Incentive levels in top 7 best performing inward investment states and 7 worst performing states



Source: ICA Incentives and fDi Markets. Inward investment performance is no. projects attracted relative to size of population and GDP. Size of incentives package is \$ incentives per job created

Conclusions and implications



- The evidence presented shows that taxes and incentives are important for investors, but are certainly not the critical drivers
- Inward investment is driven by access to markets, labor skills and increasingly to access technology/innovation rather than incentives. Indeed, quality of life is often higher ranked than incentives by investors
- The country level evidence clearly shows that FDI performance is influenced by corporate tax – which is one key explanation why the FDI performance of the USA is weak; the US has the highest corporate tax in the developed world
- But at the state level there appears to be no statistical link between corporate tax and size of incentives package and inward investment performance
- This maybe because so many states offer tax and other financial incentives that they do not significantly influence location but in their absence investors may, in some cases, invest elsewhere



- Examining the best and worst performing states shows that some of the best performing states also offer large incentives packages, indicating that incentives can be very effective
- On the other hand, some of worst performing states also offer amongst the largest incentives packages, suggesting that incentives are not effective in compensating for underlying weakness in attracting inward investment
- This study adopted unique data available on FDI performance and investment motives from fDi Intelligence and incentives packages from ICA Incentives
- More concrete research is needed to examine:
 - Incentives at a sector level and how this impacts performance
 - The impact over time of a new incentives regime on performance
 - Empirical models for location determinants using data now available
 - Concrete case study research on specific locations which are over and under performing and the role of incentives in their performance

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