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Government bail-outs and the implications for sustainable development

COMMENTARY

Stuck in reverse: recommendations on a long-term solution to a broken-down automobile industry

By Peter Wooders and Oshani Perera, the International Institute for Sustainable Development

The dramatic decline in the demand for cars has been a signature effect of the global economic crisis. Faced with a massive drop in sales - for example, 29 per cent in the case of Toyota and 49 per cent across the General Motors brands - the United States, France, Germany, Italy, Spain, and more recently, South Korea, Brazil, Japan and China have concluded that government bail-outs are both justifiable and necessary for the health of their auto sectors. However, at a time when government should be looking at the opportunity costs of all their economic stimulus plans, we wonder if rescuing the automobile industry - whose product emits a significant share of the world's GHG emissions and whose primary fuel causes much of the world's concern for security of energy supply - is a just and equitable allocation of tax payers' money.

A snapshot of car bailouts under negotiation	US\$ billion
USA	17.4
Sweden	3.4
France	7.8
Italy	2.0
Germany	7.0
Spain	1.6
Brazil	1.7
India	1.5
Russia	2.0
China	2.0
UK	3.3

At face value, it is not difficult to appreciate the logic behind these handouts. The automobile industry provides jobs, nurtures design and technology skills and creates local demand for manufactured products. Uppermost on the minds of policy makers is that the sector has a supply chain so long and diverse that, in automobile-producing economies, 1 job in every 11 depends on it. If one considers the third and fourth tier suppliers and the number of functions that are outsourced and off-shored, this number grows even higher.

We also cannot ignore the fact that the automobile industry was a pioneer of mass-production techniques and has made a phenomenal contribution to the rise of the

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industrialised world. We also recognise that globally, societies continue to maintain their dependence on cars as a symbol of personal freedom, expression and affluence. And finally, as the focus on growing new 'green jobs' gains momentum, developing domestic expertise on low-carbon innovation becomes particularly important.

But are these facts sufficient to justify such large handouts? It must be borne in mind that the automobile industry has some fundamental shortcomings: rates of return on capital are not high over the economic cycle; it has for the most part not invested in the future markets for low-carbon products and services; many companies had made significant losses even before the crisis hit; and the industry is plagued with inefficient processes and over-capacity.

The automobile industries' failure to respond to the low-carbon agenda is a particularly important case in point. When governments have attempted to impose emission targets, as the EU did in 2007, the industry has lobbied hard, claiming prohibitively high R&D costs and the supposedly "small" contribution of vehicles to global carbon emissions.

However, even putting aside the question of whether the car industry should be held responsible for the environmental performance of its products (public demand for small, efficient cars and government regulations mandating their use have also been largely conspicuous by their absence), it is still right to question whether the industry should receive publicly financed support and, if so, what conditions should be attached to it.

Stimulus packages should increase demand for those domestic industries that have a profitable future. The automobile industry is anything but this. For one, it has become so globally

However, even putting aside the question of whether the car industry should be held responsible for the environmental performance of its products (public demand for small, efficient cars and government regulations mandating their use have also been largely conspicuous by their absence), it is still right to question whether it should receive publicly financed support and, if so, what conditions should be attached.

integrated that it is not feasible for governments to help the entities and subsidiaries within its national borders without having a massive knock-on effect around the world. It is difficult to foresee how government support can be ring-fenced into feeding into the national economy alone. Indeed, maintaining jobs at domestic plants is a condition of all the bailouts, but sympathy in this regard is with the automobile industry, which will face even higher inefficiencies in complying, for the fundamental laws of economics dictates that as capital and knowledge become more mobile, jobs will move to where they can be performed most cost-effectively.

Second, we should not believe that the latest round of government bailouts will be the last. In addition to the US\$17.4 billion awarded to Chrysler and GM in December 2008 (which dwarfs all bailouts elsewhere), two firms recently submitted a renewed appeal to the USA Treasury: GM asked

for an additional US\$16.6 billion (and a further US\$13.4 billion from other governments to prop up its overseas operations) while Chrysler requested an additional US\$5 billion. This news was greeted by hasty comments from the finance ministers of France and Germany suggesting it would be 'fatal' not to support European firms while their competitors across the Atlantic were getting billions.

Continued improvements in sustainable development requires an industry which is not subsidised by periodic bail-outs and which delivers fuel-efficiency. Little can be achieved in the near term: what is needed is policy and regulation which does not allow the current situation to repeat. A wide set of measures are required:

- Address the issue of market concentration. Some financial gurus are suggesting that one of the lessons from the downfall of the banking sector is that oligopolies should be broken up in favour of more manageable and more efficient structures.
- Work out the value of supporting domestic production as against letting it migrate to countries with lower wages. Indeed, the French bail-out packages contain such express provisions on maintaining jobs in France that both the EU and the WTO have seen it fit to warn against protectionism and market distortion.
- Introduce progressive environmental regulation across the whole vehicle fleet. Governments should concentrate first on improving the fuel efficiency of the oil-fuelled vehicles that dominate the market now rather than promising future changes in the fleet at some

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INTERVIEWS

Will government bailouts lead to trade wars?

As the global financial crisis continues to worsen, many developed and some developing countries have turned to bailout packages to resuscitate stricken businesses, which could potentially violate the World Trade Organization (WTO) rules on subsidies. In fact, some countries, such as Brazil, have already threatened to launch WTO claims against countries that implement them.

In most cases, determining whether a given bailout package and the possible subsidies contained therein is WTO compliant begins with the Agreement on Subsidies and Countervailing Measures (SCM Agreement). The SCM agreement governs subsidies when they involve a financial contribution on the part of a government that confers a benefit on specific enterprises or industries.

WTO procurement provisions are another area of WTO rules that may be infringed by bailout measures. One recent such measure that has received a lot of recent attention recently is the controversial “Buy American Clause” included in the American Recovery and Reinvestment Act signed by President Obama on 17 February 2009. This clause requires public work projects funded under the Act to use U.S. iron, steel and manufactured goods.

After intense international criticism, the U.S. Senate softened the measure by adding that it must be applied in accordance with U.S. obligations under international agreements. Even so, the measure may lead to questions within the WTO framework, as well as other international commitments entered into by the United States.

Subsidy Watch has spoken to three experts on the WTO for their views on whether the certain government bailout packages violate the commitments governments have made at the WTO, and if so, whether wide-spread litigation through the WTO’s dispute resolution mechanism is to be expected. Professor Julius Sen is a Research Associate at the London School of Economics’ International Trade Policy Unit. Arvind Panagariya is a Professor of Economics at Columbia University, a Non-resident Senior Fellow at the Brookings Institute and former Chief Economist of the Asian Development Bank. Ken Shadlen is a Senior Research Fellow, Global Development and Environment Institute (GDAE), Tufts University and a Senior Lecturer in Development Studies at LSE.

Interview with Julius Sen:

SW: Since the financial crisis began last fall, certain governments such as those in the United States, Canada, Japan and Germany, have offered their banks and/or automobile industries financial bailouts, usually in the form of soft-loans and credit guarantees. Generally speaking, are these bailouts consistent with WTO rules?

The short answer is no. But there are several issues to be taken into account when analysing the specifics with reference to the application of WTO principles of non-discrimination, broken down into Most Favoured Nation and National Treatment obligations. First of all, what are the specific obligations or commitments of the Member concerned? This question is particularly important

in the area of financial services, which are subject to the rules of the General Agreement on Trade in Services (GATS) agreement and thus slightly different from the General Agreement on Tariffs and Trade (GATT) which would apply to the auto sector.

Second, governments can take emergency action for the restructuring of specific sectors, under Article XIX Safeguards, which can include financial assistance of various sorts, but they have to negotiate compensatory concessions with trading partners during the safeguard period, which I don’t think anyone has done.

Third, any grants, concessional loans or other forms of state aid have to be applied in a non-discriminatory fashion (that is for everyone in the market—which obviously has not been the case); should not be trade distorting (which of course they are); and should not have any local content obligations, which would violate the TRIMS agreement on investment conditionalities. And finally, there are European Union rules on State Aid and Competition policy that will also apply to the cases of anyone operating in the EU market, which of course includes U.S. and Japanese automakers and banks. I am not sure what the discussions have been in this area within the EU, but I doubt whether any have actually taken place.

There is an additional possibility that would take state actions completely out of WTO jurisdiction, and that is if these countries treated these rescue packages as part of national security (Article XXI). The concept of legitimate security considerations has never been defined, and is thus flexible to national interpretation.

SW: In particular, the U.S. government's 19 December bailouts of automakers Chrysler and G.M. have been criticized for violating WTO subsidies rules. What is your analysis of this view?

I agree that these actions would appear to violate WTO rules at a number of levels, but I am not aware of the full details of how these bailouts were done. Normally, a sector can be identified for restructuring under Article XIX, and during the period of restructuring, concessions have to be offered to all trading partners to make up for their loss of income in that market. In this case, I doubt whether there was any discussion with other WTO members, so there would have been no Article XIX process.

The other level of violation is that this package was only offered to U.S. automakers, not to foreign automakers within the United States. This would appear to violate the rules of non-discrimination and national treatment. And of course these financial concessions will give these automakers an advantage in export markets, including NAFTA markets, so would amount to export subsidies in such cases, which are prohibited under GATT rules. At the same time, the question of whether subsidiaries of U.S. automakers in other countries (such as Vauxhall in the UK, Saab in Sweden and Opel in Germany—all subsidiaries of GM) are entitled to U.S. bailouts, also arises. At present they are not, which has led Saab to file for bankruptcy protection. But it begs the question of how WTO rules apply to complex multinational structures with more or less autonomous subsidiaries.

Furthermore, if new technical standards are introduced to encourage energy efficient models for the U.S. market, and if select U.S. automakers alone are given money to help re-engineer their

plants to meet these new standards, and the same concessions are not given to others within the U.S. or that export into the U.S., then this too would probably be a violation of WTO rules.

In brief, the whole system is in such a mess at the moment that we will be lucky to escape a trade war, and really anything short of that will look like a success.

SW: WTO Director General Pascal Lamy recently commented that it was too early to tell what impact these measures would have on trade but warned that some "may eventually have negative spill-over effects on other markets or introduce distortions to competition between financial institutions." Do countries need to wait for these spill-over effects and distortions before commencing WTO claims?

First of all, I'm not sure I agree with the phrasing 'eventually' and 'spill-over'. The situation is in the here and now and is not a remote possibility. For instance, many countries are offering state assistance to meet trade financing requirements for exporters. This would appear to be a prima facie violation of WTO rules under the TRIMS and other agreements, which also has a very real (trade distorting) impact on the competitiveness of global exports, even now. But of course the response is also fully understandable from the perspective of managing the crisis!

WTO rules do not enforce themselves. Member States have to initiate action. At the moment everyone seems prepared to operate a general 'ceasefire' in this respect, which means

national governments (who alone can bring cases) recognise that everyone is in difficulty and confronting violations will only complicate efforts to find global solutions to the crisis. There are precedents for this, most notably in the Agreement on Agriculture which built in a ceasefire provision for the first decade of its life, precisely to avoid trade wars in an area of extreme sensitivity and complexity.

The problem will arise, most likely, in the United States, where the U.S. government has to take action under law to investigate private sector complaints and to respond through disputes or other policy instruments (such as anti-dumping actions). These are mandatory provisions that could trigger global mayhem in trade. Unfortunately, the U.S. Congress loves to adopt an assertive position on trade issues, which can make life difficult. And remember, under the U.S. Constitution, foreign trade is within the competence of the U.S. Congress alone. The president only exercises negotiating power on behalf of Congress.

SW: The Brazilian ambassador to the WTO, Roberto Azevedo, recently said that his country may contest the eventual trade distortions that will result from bailouts being offered throughout the world. According to Mr. Azevedo, artificial incentives in one country could be hazardous to companies in other countries. What do you think about this assessment?

He is absolutely correct. But given the scale of the crisis, everyone is now bailing out their economies and protecting domestic markets, though of course emerging economies don't have as much money and therefore can only offer small bailouts compared with the U.S., EU, Japan and China. As mentioned above, perhaps some sort of ceasefire in taking disputes to the WTO is needed, provided everyone agrees

to apply their stimulus and recovery packages in a non-discriminatory fashion. This is, however, an exceptionally complex issue and no one is likely to formally agree, because every stimulus package will apply differently and there will be domestic winners and foreign losers in all cases!

SW: Do you think Brazil may have a claim, in particular, against the U.S. for its financial and auto industry bailouts?

Yes. But they would be wise to wait a while before reacting formally. Perhaps negotiating with the United States and others would be more productive because it is probably more important, at this stage, to keep U.S. markets open for imports than it is to fight individual cases.

SW: Some experts suggest that claims such as these will probably never happen. Given the number of countries that have and will be offering bailouts, it has been argued that negotiated settlements are more likely. What's your opinion?

In a sense I agree. But the problem is the bailouts are not all the same and there are clear winners and losers, and so the burden and benefits will be distributed unevenly. One option is to have a general ceasefire, but the danger is that protectionism and discrimination would revive to an extent that it renders WTO principles inoperable. The second is to fight every violation, but this will only irritate the U.S., EU, Japan and others, making a final solution more difficult. The third option is to negotiate a new WTO provision providing for non-discriminatory bailouts, stimuli, etc. This is possible, but no one really understands the implications in terms of scale of money or market effects, or would know how to start negotiating and how long it would take.

Bilateral negotiations would seem to be the most viable alternative at the moment, but this will work against the weakest countries for which multilateralism offers the best hope. In brief, the whole system is in such a mess at the moment that we will be lucky to escape a trade war, and really anything short of that will look like a success. But of course it will come at a price: the severe erosion of WTO principles.

Interview with Arvind Panagariya:

SW: Since the financial crisis began last fall, certain governments have offered their banks bailouts. Generally speaking are these bailouts consistent with WTO rules?

Banking falls under GATS, which has no rules on subsidies. However, bailouts that favour domestic banks and discriminate against foreign banks can result in the violation of market access and national treatment commitments. If the damaged parties bring cases to the WTO Dispute Settlement Body (DSB) related to the banking sector, it will be a new frontier for the WTO, since subsidies to service sectors are currently not subject to any disciplines.

SW: In particular the U.S. government's December bailouts of automakers Chrysler and G.M. have been criticized for violating WTO subsidies rules. What is your analysis of this claim?

Regarding the auto industry, in so far as there is an element of subsidy in the credit offered under the bailout plan, a violation has definitely occurred. The real issue is whether the damaged parties will bring cases to the DSB. If no country brings a case, offending parties will get away with it.

SW: Under the terms of that bailout the Treasury Department agreed to

loan up to US\$13.4 billion to GM and up to US\$4 billion to Chrysler at an interest rate of 3% percent above the London Interbank Loan Offered Rate (LIBOR). What do these terms say about the legality of this bailout under WTO rules?

In principle, if the terms are better than what is available on the market, a subsidy exists and there is violation.

SW: The controversial "Buy American Clause" included in the American Recovery and Reinvestment Act signed by president Obama on 17 February 2009 has received a lot of attention, so much so that the Senate revised it to say that it must conform to U.S. international obligations. What is your take on this provision?

The final version agreed between the House and Senate requires WTO consistency. But this may not be sufficient to rule out retaliation. For example, as a plurilateral agreement, the GPA (Government Procurement Agreement) allows the U.S. to discriminate against non-signatories such as Brazil and India. If the U.S. does resort to this flexibility and discriminates against them, they could retaliate in a WTO-consistent manner. Brazil and India have bound tariffs on products exported by the United States that far exceed the corresponding applied tariffs. They could raise the applied tariff rates all the way up to the bound rates without violating WTO rules.

Interview with Ken Shadlen:

SW: Do the government by bailouts by the major industrialized countries pose a particular threat to developing countries which lack the funds to compete in the bailout game?

Yes, developing countries are disadvantaged in that they have less

funds available to subsidize and so on, though this is always the case. One could argue that the WTO rules, in particular the ASCM, were written in such a way as to permit the sorts of subsidies that are more useful in developed countries and prohibit the sorts of subsidies that are more useful in developing countries. So, yes, what you're describing is really an accentuation of a pre-existing asymmetry in countries' abilities to exploit the permissiveness of the WTO.

That said, one could argue that the subsidies and bailouts we are seeing now may actually benefit developing countries to the extent they generate recovery in their principal export markets, such as the United States, the EU, and Japan. After all, if OECD countries are in recession then demand for developing countries' exports are low, which affects employment and debt-servicing capacities and so on, so developing countries have an interest in OECD countries doing what they can to prevent a long and deep recession or depression.

Ultimately, to get a sense of the effects, you need to look at countries' export profiles, and the extent to which a given country exports goods are, or are not, affected by the interventions being put in place around the globe. Just to give an example, if a country exports steel and machine tools and transportation equipment to the United States, then the sorts of measures introduced in the U.S. might hurt as it loses exports in key sectors. However, if a country exports shirts and shoes it would probably be less negatively affected. In short, to say anything with any confidence, we have to look carefully at the details of the programmes being put in place and different developing countries' industrial and export structures.

SW: Do you expect there will be a large number of disputes between WTO Members related to the recent government interventions?

In general I don't expect there to be so many WTO-related disputes, given the number of countries involved. It is not at all clear what is and is not legal; and it is very difficult to demonstrate that another country's subsidy is causing damage.

There is, however, a more interesting (and probably overlooked) reason why there are unlikely to be disputes, and that regards the way the WTO dispute settlement system works, which is to order countries to stop violating an agreement and then authorize the injured country to retaliate if the violating country does not remove the illegal measures.

These bailouts or subsidy programs (whatever you want to call them) all seem to me like one-off and time-delimited interventions, not on-going changes to countries' policies and practices. What this means is that by the time any country could prove that another country's intervention is causing damage and violating some agreement, the money will have been spent and the program terminated. If I am correct in my non-lawyer's understanding of how the WTO works and what these bailout-rescue-subsidy programs entail, then it would seem that, in addition to the reasons that I note above, countries will have little incentive to exhaust resources pursuing cases through the WTO's dispute-settlement mechanism.

SW: The controversial "Buy American Clause" included in the American Recovery and Reinvestment Act signed by president Obama on 17 February 2009 has received a lot of attention, so much so that the Senate revised it adding that it must conform to U.S. international obligations. What is your take on this provision?

My sense is that the revision probably allows the United States to go about doing this in a way that does not violate commitments under the WTO's GPA (Government Procurement Agreement) and also the government procurement provisions in the many regional and bilateral trade agreements the U.S. has signed (these also include government procurement regulations). The last-minute change to the U.S. Act, stipulating that it will be implemented in accordance with international obligations, likely means that government procurement will be done in a way that allows companies from GPA parties and Regional and Bilateral Trade Agreement partners to participate.

SUBSIDY SPOTLIGHT

Germany subsidies for solar power

One of the hallmarks of poorly designed subsidies is that they exacerbate the problem that they were meant to solve. Such is the case of Germany's 1991 renewable-energy law, which guaranteed higher than market rates for electricity produced from renewable sources. The law was intended to give a boost to renewable energies, such as solar power. In fact, it led to such high demand for solar power in Germany that the world-market price for high-grade silicon jumped from US\$25 per kg in 2003 to some US\$400 in 2008. As *The Economist* newspaper notes, "this is wonderful for manufacturers, but makes it more expensive to install solar capacity in sunnier parts of the world, where it would generate more electricity."

Source: "German lessons", *The Economist*, 3 April 2008

RESEARCH IN BRIEF:

Biofuel subsidies in Asia; the link between corn subsidies and obesity; and the competition to attract investment in Southeast Asia

Subsidies for biofuels in China, Malaysia and Indonesia

Three recent reports by the Global Subsidies Initiative (GSI) survey subsidy policies for biofuels in China, Malaysia and Indonesia.

The reports marks a shift in focus for the GSI's "Biofuels At What Cost?" series, from biofuel subsidy policies in OECD countries—which account for the lions share of global government support for biofuels—to that of certain developing countries that have stood poised to capitalize on heightened interest in these renewable fuels.

Indonesia and Malaysia, in particular, contemplated ambitious biofuel policies several years ago, only to find that high commodity prices over much of 2007 and 2008 put biofuels largely beyond the reach of any but the wealthiest nations that can afford to maintain subsidies, explains the GSI.

Nonetheless, Indonesia and Malaysia have spent public funds on promoting biofuels. According to Indonesian government figures, total government allocations for biofuel development between 2006 and June 2008 reached up to IDR 1 500 trillion (US\$1.6 billion). However, the GSI notes that it is unlikely that all of these funds were disbursed. In Malaysia, meanwhile, support has been limited to RM 60 million (US\$16 million) in low-interest loans in 2004, and RM 12 million (US\$3.3 million) in federal grants for demonstration projects in 2006.

Both countries continue to consider expanding their incentives for biofuels, in particular by instituting blending mandates (i.e., mandating that gasoline

and diesel be blended with a certain percentage of ethanol or biodiesel). However, the GSI cautions against this policy, on the grounds that the cost could far outweigh the benefits in terms of reduced GHG emissions or improved energy security, the two primary rationales behind biofuel subsidies.

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"Indonesia's experience with petroleum pricing has clearly demonstrated that fuel subsidies can become a major drain on the economy," writes the GSI. "Letting fuel prices rise to levels prevailing in international markets would reduce consumption and improve efficiency, resulting in improved energy security. Adding an additional layer of subsidies for biofuels to an already distorted system makes little economic sense."

Similar advice is offered to China. That country had already backtracked on some of its earlier plans for biofuels, once it became clear that an expansion of certain biofuel stocks would weaken food security. Construction of maize-based ethanol plants has been

halted, and the Chinese government is promoting the use of non-grain feedstocks grown on marginal land.

Nonetheless, the GSI warns that converting "marginal" lands for feedstock production could disrupt natural ecosystems, as well as hurt vulnerable rural communities. China should proceed carefully "to ensure that biofuels genuinely do not compete with food or undermine the government's social or environmental objectives," says the GSI.

Links to all three reports can be found from the GSI website at <http://www.globalsubsidies.org/en/research/biofuel-subsidies>

Have US farm subsidies made Americans fat?

A policy brief from the Global Development and Environment Institute (GDEI) at Tufts University examines the link between bloated U.S. farm subsidies and expanding waistlines in the United States.

Consumer advocates have argued that US farm subsidies that lower the cost of corn are a key reason why consumption of high fructose corn syrup (HFSC) has skyrocketed over the last four decades. Other researchers are more skeptical of the link, however, arguing that the impact that corn subsidies have on the prices of products like soft drinks is not significant enough to have a major impact on consumption.

The GDEI brief, authored by Alicia Harvie and Timothy A. Wise, estimates how much subsidized corn has lowered the cost of HFSC. The GDEI estimates

that, through 2005, corn was priced about 27% below cost due to implicit government subsidies, and on the basis that corn represents 44% of the cost of producing HFCS, the authors conclude that the wet milling industry saved about US\$2.19 billion between 1997 and 2005.

Soda makers, in turn, saved about US\$873 million over the same period thanks to subsidized corn, according to the GDEA.

So can low-cost corn be blamed for the obesity epidemic in the United States? While it has not helped, the authors conclude that “HFCS just isn’t a large enough share of consumer prices to be the primary cause of over-consumption.”

The Sustainable Development impact of Investment Incentives, in Southeast Asia and beyond

A network of developing country research institutes that examine trade policies has published two reports that highlight the impacts, negative and positive, of subsidies designed to attract investment.

A “Checklist for Assessing the Sustainable Development Impacts of Investment Incentives”, published by the Trade Knowledge Network, provides a set of questions for government officials and other stakeholders to consider when designing investment incentives, in order to better ensure that they contribute to economic development, as well as sustainable development more broadly.

The author of the checklist, Kenneth P. Thomas of the University of Missouri-St. Louis, notes that while certain investment incentives have been credited with attracting investments, others have left doubts as to whether the investment would have still been made in the absence of the incentives.

Indeed, those studies that have attempted to determine whether investment incentives have contributed to economic development leave some doubt. The report says that “even some of the more optimistic of these analyses estimate that less than ten per cent of apparent jobs were truly due to the effect of the incentive. Moreover, many times job creation in one jurisdiction is soon offset by job cuts at other facilities of the same company, or by cuts at other companies due to their succumbing to subsidized competition.”

The checklist is not the first of its kind, coming on the heels of the OECD’s 2003 “Checklist for Foreign Direct Investment Incentives”. However, unlike the OECD checklist, the TKN considers the impacts of investment incentives beyond economic effects, such as their impact on the environment.

In addition to the checklist, the TKN has recently published a study on investment incentives in Southeast Asia, a region where investment incentives are prevalent. While the region has seen a 15-fold increase in FDI over the last two decades, the degree to which investment incentives actually influence investment decisions is poorly understood, says the author, Heike Baumüller. How particular incentives impact the environment is even less well researched.

The report, “Competing for Business: Sustainable Development Impacts of Investment Incentives in Southeast Asia”, provides an overview of how foreign investment has contributed to development in the region, the various incentives that these countries offer, and the bilateral and regional rules that currently govern foreign investment. The report also sheds light on the regional dynamics with respect to competition for FDI, such as the influence that China’s rapid economic development has had on both encouraging and diminishing foreign investment in other countries in the region.

Baumüller and Thomas both draw attention to potential bidding wars within states (i.e., between municipalities or provinces) or between states, as a potential point of concern.

“Some have argued that competition for mobile capital can be healthy, facilitating the efficient allocation of investment and encouraging governments to improve the investment environment more generally,” writes Baumüller. “More commonly, however, concerns have been raised that competition can lead to ‘bidding wars’ that will leave all bidders no better or even worse off in the end.”

Fact Box

Estimated gallons* of water used to produce fuel to drive a family sedan one Mile (1.61 Kilometers):

Gasoline: 1

Plug-in hybrid-electric: 10

Hydrogen: 25

Ethanol: 40-130

Source: Center for International Energy and Environmental Policy, University of Texas at Austin

***1 US gallon = 3.79 litres**

NEWS IN BRIEF:

Nigeria considers cut in fuel subsidies

The Nigerian federal government has announced plans to cut its subsidies for petroleum fuels, saying that the price tag has become unaffordable.

According to the federal government, Nigeria spent over US\$4.3 billion on petroleum fuel subsidies in 2008.

Despite its significant oil reserves, Nigeria imports much of its petroleum products, before selling them at below market rates.

The government plan, announced in late February, includes deregulating prices and privatizing oil refineries.

The Nigeria Labour Congress, an umbrella group for labour organizations, is resisting, calling the decision “ill-advised”, according to media reports in the country. Efforts to cut fuel subsidies have, in the past, been met by public protests in Nigeria.

President Obama’s budget plans for cut in agricultural subsidies

U.S. President Barack Obama’s proposed 2010 budget includes reform to agricultural subsidies, including a phasing-out over 3 years of direct payments to farmers who make more than US\$500 000.

The Obama administration expects that its proposed reforms would save US\$16 billion over the next 10 years.

However, as the *Reuters* news agency reports*, the proposed cuts in agricultural subsidies will have a tough time passing the U.S. Congress.

“We just passed a fiscally responsible

Farm Bill that made cuts to farm programs, so now is not the time to reopen it,” said House Agriculture Committee chairman, Collin Peterson, as report by Reuters.

Speaking to the publication *Inside U.S. Trade*, University of California professor Dan Sumner said that limiting direct payments based on sales makes little economic sense, as it would still provide these subsidies to retired or weekend farmers. It would be better to scrap direct payments altogether, said Sumner.

*Criticism rains on Obama’s farm subsidy cut idea”, By Charles Abbott, Reuters, 1 March 2009

New project builds database on U.S. federal subsidies

The Pew Charitable Trust has set up a project called Subsidyscope that aims to raise awareness about federal subsidies in the U.S. economy. Over the next several years, the project plans to build searchable databases on federal subsidies, sector by sector.

The project, launched in December 2008, has already pulled together a database on the so-called Transactions under the Troubled Asset Relief Program (TARP). Under the program, the U.S. government has taken equity stakes in struggling companies. As Subsidyscope explains, an implicit subsidy is provided when companies receive more in federal funding than the market value of the preferred stock and warrants that the government receives in exchange.

Explaining the rationale behind the project, John E. Morton, managing director of Pew’s Economic Policy Department said: “Too often

policymakers speak as if subsidies are limited to direct expenditures on assorted social programs. The reality is that, increasingly, they flow through the tax code and are not subject to the same level of public oversight. In our fiscally constrained environment—and with government interventions shifting new burdens onto American taxpayers—there is more need than ever for a comprehensive and transparent fact base to inform future discussions about subsidies.”

Stuck in reverse...

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indeterminate future date through the introduction of electric or hydrogen vehicles.

- Encourage governments to be more transparent on the subsidies they provide to the industry, and provide full accounts of what support has been provided and appropriate metrics for judging their cost-effectiveness.
- Avoid subsidising investments that would have taken place even in the absence of incentives.

What governments do now will dictate what position they find themselves in during the next downturn: will they again be bailing out an industry whose finances and products remain unsustainable or will the actions taken now give rise to a proactive and competitive sector that will be the hallmark of a sustainable future?

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