

Notes

1 Public Support to Business: An Overview

1. We include R&D in the externalities category under the heading of knowledge externalities.
2. As stated in the Introduction, economists often include rescue to sector or firms in difficulties and equity purposes among public support objectives. For clarity and efficacy, this study does not cover these aspects.
3. Chapter 4 presents a more detailed discussion of this subject.

2 Cases for Public Support: Market Failures

1. An example of investment guarantee can be found in South Korea practice, where the regime of President Park gave implicit investment guarantees to leading Chaebols engaged in new areas of investment. However, this type of public support is open to moral hazard and abuse (Rodrik, 2004).
2. An optimal tariff is one that improves a country's terms of trade to the detriment of its trading partners.

3 Argument Against Public Support: Government Failures

1. In other documents the Commission cites other goals such as consumer welfare (e.g. Merger Regulation) or total welfare (e.g. state aid to R&D).

4 Instruments of Support: Subsidies and Public Procurement

1. The appellate body has ruled that the existence of a benefit is to be quantified by comparison with the market place. The Appellate Body Report in Canada Aircraft (WT/DS70/AB/R2, 2 August 1999) noted that the existence of a benefit is a core element of the definition of a subsidy 'only' in cases where the financial contribution provides the recipient with an advantage over and above what it could have obtained on the market will the government's financial contribution be considered to have conferred a benefit and will a subsidy thus be deemed to exist. 'If the public or publicly directed financial contribution is provided under the same conditions as a private market player would have provided, then there would be no reason to impose any discipline, simply because the financial contribution was provided by the government.'
2. OECD National accounts of OECD countries, vol. 1, p. 369, 2005 and United Nations 1993, system of national Accounts, chapter VII, D3.
3. The Classification of the Functions of Government (OECD Secretariat: 30 April 1997) provides a definition for each function. For instance,

economic affairs concern services and goods provided to the administration of applied research and experimental development, operation of government agencies engaged in applied research, support for applied research and commercial and labour affairs undertaken by non-government bodies such as research institutes and universities. It also includes the administration of labour affairs and services (e.g. the formulation and implementation of general labour policies and regulations concerning labour conditions) and the administration of general economic and commercial affairs and services (e.g. the formulation and monitoring of economic and commercial policies and regulation).

4. Neven (2004) proposed to define the relevant market in state aid as the set of products which would be seriously affected by a subsidy to a particular firm. This definition has not the same objective as market definition for antitrust. Once the market definition is achieved, it will be necessary to identify how the state aid affects the behaviour of the recipient and to identify how the strategy of the recipient affects the competitors in the relevant market.
5. The Dispute Settlement Body consists of all WTO Members and has the authority to establish 'panels' of experts to consider the case and to accept or reject the panels' findings. The panels are like tribunals but the panellists are chosen in consultation with the countries in dispute. They consist of three to five experts who prepare a report on the evidence which concludes who is right and who is wrong. The panel may decide that the subsidy measure does break the WTO rules. The panel's findings can be appealed to the Appellate Body, whose report is final.
6. In the United States, the federal government has no state aid control at the federal level for controlling or coordinating the aids by the individual states. The Constitution grants Congress the power to regulate commerce 'among the several states'. Under a legal theory known as the negative commerce clause, the Supreme Court can strike down state taxes and regulations that have the effect of taxes when it finds them to be protectionist, favouring businesses within a state and thus discouraging national commerce. However, there is no recent evidence that subsidies have ever led to interstate litigation. In 2006, the Supreme Court took up a case (*DaimlerChrysler v. Cuno*, No. 04-1704, and *Wilkins v. Cuno*, No. 04-1724) about the legality of tens of billions of dollars in tax breaks that states and local governments award businesses each year to build new factories and offices. But the case was filed by a group of Ohio residents, not other states whose interests might have been harmed. Russia, another state with a federal structure, has recently adopted a state aid control legislation, which applies only to state aid granted by the regions, and not to the federal level spending.
7. Such concerns may arise, for instance, under the situation of considerable uncertainty about the probable costs of meeting by buyer's requirements when they are difficult to specify in a simple way. The bidders are likely to differ in their estimates. If bidders were to bid in line with their cost estimates, the bidder with the lowest cost estimate would win the tender, but this bidder would probably have underestimated the cost of delivering the required goods or services. Therefore, rational bidders are expected to bid with a sufficient safety margin to avoid an outcome in which winning a tender may lead to losses. As for the safety margin, it might be expected to

be larger, the greater the uncertainty about the true cost, and the larger the number of bidders, so that the price paid by the buyer can increase as a result of allowing more participants to submit bids.

8. For a numerical approach, see Bajari (2001).
9. Incumbency advantage means that a public contractor, due to the fact of having a procurement contact once or even several times, develops a better understanding of the public sector's requirements and needs or has made investments that provide advantages over other firms.

5 Effectiveness of Public Support

1. Although, this may be an indirect policy factor stimulating private R&D expenditure.
2. In particular, some macroeconomic growth models include R&D as an endogenous factor of growth. In particular, Segerstrom (2000), shows that subsidies towards R&D can promote or reduce long-run economic growth, subsidies change allocation of resources between horizontal and vertical innovations. While in a short run innovation is expected to increase efficiency or bring about other positive results, in the long run, however, it might result in increased complexity. Thus, a permanent R&D subsidy can have a negative impact on economic growth. However, there is no robust theoretical result and the main outcome is quite ambiguous.
3. The reasons of firms' difficulties (e.g. market decline and poor management) are based on the rescue and restructuring state aid decisions of the European Commission. The latter generally provide some information about the reasons why the company, which is the beneficiary of the aid, ran into business difficulties.
4. The British New Deal for Young People is a policy that prevents young people from entering long-term unemployment.
5. They present a model in which politicians fund projects that are wasteful as a way to signal their diligence, and voters rationally reward them for this.
6. The sample includes 32 countries: Hong Kong, India, Japan, Korea, Malaysia, Singapore, Thailand, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom, Canada, Mexico, United States, Brazil, Australia, New Zealand, Indonesia, and Hungary.
7. The authors measure concentration in a way that may appear counter-intuitive in regard of the traditional concentration ratio widely used by industrial economists.
8. Japan's benchmark countries are Italy, Finland, Austria, Australia, France, and the Federal Republic of Germany. For Korea, the countries of comparison are Uruguay, Portugal, Malaysia, Mexico, and Panama.

6 Subsidies and State Aid

1. The International Monetary Fund's Government Finance Statistics is also a possible source on government subsidies but the definition used by the IMF is narrow.

2. See also the methodological remarks at http://ec.europa.eu/comm/competition/state_aid/studies_reports/conceptual_remarks.html
3. As mentioned in the autumn 2006 report, the manufacturing sector in the scoreboard includes the traditional manufacturing sector but also aid for general economic development, aid for horizontal objectives, SMEs environment, energy saving, employment and training. Therefore, aid to manufacturing may be overestimated.

7 Public Procurement

1. According to Evenett and Hoekman (2005) one source of this uncertainty comes from the fact that data on total government expenditure levels, in particular on central government outlays, include certain payments (such as compensation for government employees) that are not usually the subject of state contracts with private sector firms of other suppliers. Moreover, the data do not take account of 'in-house' activities (i.e. when public authorities provide services themselves). There have been few attempts to correct for these factors. The latest comprehensive study is OECD 2002 *The Size of Government Procurement Markets* (Paris) which employs the System of National Accounts (SNA) to compute the magnitude of procurement of goods and services by state bodies in 106 developing countries in 1998.
2. See the Annexes 1 to 5 of the Appendix I of the Agreement of Government Procurement.
3. Although the EU members are signatories of the GPA, they did not report to the WTO figures on public procurements.
4. *Intermediate consumption* consists of the value of the goods and services consumed as inputs by a process of production, excluding fixed assets whose consumption is recorded as consumption of fixed capital. The goods and services may be either transformed or used up by the production process.
5. *Social transfers in kind* consist of individual goods and services provided as transfers in kind to individual households by government units and Non-Profit Institutions Serving Households (NPISHs), whether purchased on the market or produced as non-market output by government units or NPISHs. They may be financed out of taxation, other government income or social security contributions, or out of donations and property income in the case of NPISHs.
6. Troinfetti (2000) uses the same data source.
7. It concerns services and goods provided to the population in case of sickness, disability, old age and death. See *Classification of the Functions of Government*, OECD Secretariat: 30 April 1997.
8. The figures refer to defence procurements not to the defence budget in general.
9. This concerns services and goods for the functioning of police and fire protection, law courts, prisons, etc.
10. This concerns services and goods provided to the administration of applied research and experimental development, operation of government agencies engaged in applied research, support for applied research and commercial and labour affairs undertaken by non-government bodies such as research institutes and universities. It also includes the administration of

labour affairs and services (e.g. the formulation and implementation of general labour policies and regulations concerning labour conditions) and the administration of general economic and commercial affairs and services (e.g. the formulation and monitoring of economic and commercial policies and regulation). See *Classification of the Functions of Government*, OECD Secretariat: 30 April 1997.

8 Public Support in Germany

* Christian Lechner is the main contributor to this chapter. He is Professor at the Toulouse Business School.

1. OECD (1998) 'Spotlight on public support to industry'.
2. The term *Mittelstand* refers to medium-sized companies rather than to small firms and traditionally includes companies with up to 500 employees compared to the limit of 250 employees used by the EU. Governments in Germany have often refused to define the *Mittelstand* by size criteria, preferring to define it as a particular spirit, or by the unity of ownership and management. Support programmes in Germany targeted to 'SMEs' vary widely in their understanding of SMEs. Some follow the EU definitions for sales and employees, others the German *Mittelstand* definition of 500 employees (also adopted by the Federal Ministry of Economy) and others again a maximum sales volume of €500 million.

9 Public Support in France

1. Aid to companies in financial distress is, in contrast, considered by the authors of the report as a form of social policy, even though the government presents it as an element of industrial policy. Such aid has concerned, for example, the shipbuilding, textile, and steel industries.
2. The Beffa report began with a worrying report on the competitiveness of French industry, recording an overall decline of the weight of France in industrial added value, from 7.5% of total industrial added value in the OECD countries at the beginning of the 1980s to 6% at the end of the 1990s; a low degree of specialization in high-tech industries. High-tech industries (OECD definition) contributed 14% of industrial added value in France in 2000, versus just fewer than 20% in Japan and 28% in the United States; a low degree of industrial specialization in international trade; and a low degree of innovation.
3. For businesses that are claiming this credit for the first time and for those which have not claimed it in the last five years, the rate is 50%.
4. A patent is considered triadic if it is filed at the European, Japanese and the US Patent Office. In general, only invention with a very high potential for worldwide exploitation is patented as a triadic patent.

10 Public Support in the United Kingdom

1. At present the Department for Business, Enterprise and Regulatory Reform encompasses functions from the former Department of Trade and Industry with the Better Regulation Executive (BRE), previously part of the Cabinet Office.

2. Stephen Byers is a former Secretary of State for Trade and Industry (December 1998–June 2001).
3. RSA is only available for up to 15% of ‘eligible’ project costs, which primarily include buildings, plant and machinery, and land, the rest of the cost of the project must be met by the firm itself. There is also a cost-per-job ceiling that mitigates against large capital-intensive projects.
4. In reality, RSA grants have been particularly useful as an incentive for foreign direct investment (FDI). Value of grants to foreign firms is estimated to be in receipt of over 40% of RSA.
5. It seems that this aspect of the Enterprise Fund is being investigated by the European Commission for compatibility with its state aid rules.

11 Public Support in the United States

1. See also <http://www.census.gov/govs/www/class06.html>
2. In September 2004, the Supreme Court announced that it had agreed to review a federal appeals court ruling that certain Ohio tax credits granted to business as an incentive to expand operations in the state violated the Commerce Clause of the US Constitution. The federal appeals court reached its conclusion on the grounds that the economic effect of the Ohio tax credit is to encourage further investment in-state at the expense of development in other states and that the result is to hinder free trade among the states. The Supreme Court has ruled in favour of the State of Ohio, for a surprising reason. Since the case was, first, brought by Ohio residents rather than by other states (whose interests might have been harmed), it argued that the plaintiffs did not have a sufficient interest (standing): *New York Times*, 1 March 2006.
3. The ‘B-index’ measures the relative attractiveness of R&D tax treatment in a given jurisdiction. The more favourable the tax treatment of R&D, the lower is the index.
4. Except for one case: *DaimlerChrysler v. Cuno*, No. 04-1704, and *Wilkins v. Cuno*, No. 04-1724. In 2006, the Supreme Court took up the case about the legality of tax breaks that states and local governments award businesses each year to build new factories and offices. But the case was filed by a group of Ohio residents, not other states whose interests might have been harmed.
5. Information on all government assistance schemes is available from the Catalog of Federal Assistance, a database of all federal programs available to business and other entities: <http://www.cfda.gov>
6. Large, Fortune-500 companies participating as a single firm must pay at least 60% of total project costs while small- and medium-sized companies working on single firm ATP projects must pay a minimum of all indirect costs associated with the project.
7. Department of Agriculture, Department of Commerce, Department of Defence, Department of Education, Department of Energy, Department of Health and Human Services, Department of Homeland Security, Department of Transportation, Environmental Protection Agency, National Aeronautics and Space Administration, National Science Foundation.
8. Department of Defence, Department of Energy, Department of Health and Human Services, National Aeronautics and Space Administration and National Science Foundation.

12 Public Support in Japan

1. SMEs are defined in Japan as enterprises with less than 300 employees: in 2005 they represented 71% of total employment and 99.7% of the total number of enterprises.
2. The surveys are published in the annual report 'Japan's Government Procurement Policy and Achievements'.

Conclusions

1. This concerns services and goods provided to the population in case of sickness, disability, old age, and death. See Classification of the Functions of Government, OECD Secretariat: 30 April 1997.

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