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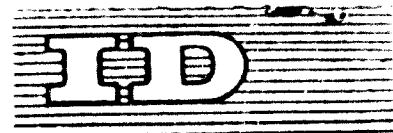
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INDUSTRIAL POLICIES AND THE ROLE OF

INCENTIVE MEASURES<sup>1/</sup>

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INDUSTRIAL POLICIES AND THE ROLE OF  
INCENTIVE MEASURES

Issues for discussion

I. INTRODUCTION

1. For the purpose of this paper, industrial policies are defined as those economic policies which have a direct effect on the process of industrialization. It is recognized that some industrial policies defined in this way merely represent the influence of more general economic policies on the industrial sector; other policies have been designed with the industrial sector specifically in mind. These policies include such important elements of national economic policy as: the tariff structure, other trade and foreign exchange policies, monetary and credit policy, budget and fiscal policy, etc.; they also include the Government's policy on ownership of enterprises in the industrial sector.

2. The term "incentive policies for industrial development" is used in this paper to describe those policies and measures adopted by a Government to provide an additional stimulus for industrial development. By "additional stimulus" is meant a form of encouragement and/or removing of obstacles which would be absent but for the introduction of an incentive measure.

3. Eight different types of incentive measure will be considered at the Seminar:

- (a) Assistance at the pre-investment stage;
- (b) Assistance with land, factory buildings, etc;
- (c) Assistance with financing;
- (d) Assistance with the development of labour skills;
- (e) Import duty concessions;
- (f) Protection from foreign competition;
- (g) Tax incentives for industrial development;
- (h) Measures to facilitate foreign investment.

4. From this list, it can be seen that four types of incentive measure represent a modification of existing industrial policies. Import duty concessions and protection from foreign competition represent a modification of the tariff structure and other trade and foreign exchange policies. Assistance with financing when used as an incentive measure is a modification of the existing monetary and credit policy. The effectiveness of tax incentives depends on

the fiscal and budget policy of the Government. Three of the other types of incentive measure considered (assistance at the pre-investment stage, assistance with land, factory buildings, etc. and assistance with the development of labour skills) are a form of subsidy which help remove obstacles which might otherwise deter the implementation of industrial projects by private investors. Finally, measures to facilitate foreign investment are inter-related with many of the above incentive measures.

## II. THE PROBLEM

5. Targets for the contribution of the industrial sector to the economic growth of a country are generally expected to be established within the framework of the general economic development plan of the country or, in the absence of such a plan, within the context of a general policy for balanced economic development. It is generally recognized that the achievement of the targets set for the industrial sector depends upon the formulation of a set of appropriate industrial policies and their successful implementation.

The first aspect of the problem, then, is to formulate and implement a comprehensive package of industrial policies within the overall framework of national economic policies and as an integral part of it in order to achieve the targets established or expected from the industrial sector within the growth targets for the economy as a whole.

6. Except in centrally-planned economies, the achievement of these targets depends on the performance of both the public and the private sectors. The importance of their respective roles in contributing to industrial development varies from one country to another. It is generally accepted that targets set for the development of industry in the public sector can be secured by direct measures taken by the Government such as the allocation of appropriate funds, the setting up of appropriate institutional arrangements, etc. It is also generally recognized that the contribution to industrial development from the private sector depends on the successful encouragement of private investment in industry rather than in traditional areas for private investment such as building and trading.

Therefore, the second aspect of the problem is the formulation and the implementation within this framework of industrial policies, of a comprehensive package of incentive measures capable of stimulating and encouraging private investors (domestic and possibly foreign) to achieve the contribution expected from it to the industrial development within the framework of the national economic development.

7. This Issue Paper will concentrate on the second aspect, keeping in mind the first aspect. The aim is to examine the relationship between incentive policies and industrial policies within the overall framework of national economic policies with a view to identifying possible areas of conflicts between them, the issues raised by these possible conflicts, and ways of eliminating or overcoming them.

### III. SURVEY OF ISSUES RAISED

8. The issues considered in this paper can be grouped under two headings:

- A. The relationship between incentive policies and industrial policies
- B. The role of incentive policies

#### A. The relation between incentive policies and industrial policies

9. The issues raised by this relationship can be discussed with reference to the nature of the relationship. While the policy on ownership in the industrial sector determines the scope and importance of incentive measures, the relationship with the other major industrial policies raises the problem of possible conflicts between incentive measures, industrial policies and national economic policies.

##### 1. Ownership policy

10. It is generally stated that irrespective of the degree and importance of the contribution of the private sector to the national economic growth, this sector in order to invest in industry at the desired level should be encouraged by the formulation of a set of adequate incentive measures in the event that prevailing conditions and policies do not provide sufficient stimulus.

11. Therefore, the issue arises: Is there a relationship between the importance of the investment set or expected from the private sector and the formulation of incentive measures, particularly as to their generosity vis-à-vis this sector? Can this generosity be considered as a function of the importance of the targets expected to be achieved by the private sector in industrial development?

12. This issue leads to a number of other issues related to the division of investment between the private and public sectors. For example, do incentive measures need to be reviewed in connection with both any change in the Government ownership policy in the industrial sector and the development of the private sector itself? Should less generous incentives be considered when the private industries become sufficiently self-generating of new investment? Or should the incentive measures be re-adjusted gradually to meet with a policy of a more balanced division of investment between the private and public sectors?

2. The relationship with the major industrial policies.

13. It is generally accepted that industrial policies are an integral part of the national economic policy and that the incentive measures are part of the industrial policies. The issue arises: How could possible areas of conflict be identified with a view to preventing them or, where possible, eliminating them?

14. Although it is not possible to cover all the issues raised by this possible conflict within each of the major policies, this paper will attempt to review some of them. In doing so a distinction can sometimes be made between conflicts which arise from the process of industrialization itself and conflicts which arise as a result of the introduction of incentive policies.

15. A number of countries have faced the conflict between the goal of raising budget revenue and promoting industrialization. This conflict arises when import duty concessions are granted; the introduction of a protective tariff results in the elimination of imports of certain products without a compensating increase in tax revenue. The conflict becomes much sharper if tax incentives are provided in a form which results in new industrial enterprises paying little taxation on corporate profits in the early years of their establishment. In Argentina, for example, budgetary



difficulties led to a critical appraisal in 1963 of those incentive measures which resulted in substantial losses of revenue.

16. Measures to ease industry's financing requirements and make industrial investment more attractive have in some countries conflicted with some general economic policy objectives, particularly that of maintaining internal and external economic stability. In some countries inflation, resulting among other factors from the expansion of monetary demand, has made it more difficult to attract foreign capital. A new investment law was passed in Chile in 1960 which permitted enterprises to re-value their fixed assets each year in line with the depreciation of the exchange rate.

17. In Ecuador the basic objective of the monetary and foreign exchange policies has been to maintain monetary stability. Credit policy has helped to facilitate the financing of industry, but the main assistance with financing has come from a state-owned Industrial Development Bank established by the Government in 1964 and a similar bank established by private interests. The roles of other institutions in financing industrial investment have been limited for the sake of monetary stability.

18. The country papers show that incentive measures, as well as industrial policies, often conflict with the balance of payments policy. Industrialization has been the principal source of a rising import bill in many countries, and the import-substitution process has not saved as much foreign exchange as expected. Balance of payments difficulties which result from this and other factors and persistent inflation have made it necessary to introduce economic stabilization policies in Argentina from time to time; these policies have led to a substantial reduction in the rate of growth of the economy and consequently in the demand for the products of local industries. This slowing down has offset to a certain extent the effect of the incentive measures offered by the Government.

19. In Chile, the main national economic policies which have affected industrialization are those related to the balance of payments. Two important relationships can be identified. Industrialization has contributed to the development of difficulties with the balance of payments; but later on the resulting need to conserve foreign

exchange has provided more effective protection for local industries and hence stimulated their development.

20. The incentive measures may sometimes conflict between themselves, particularly when they aim to serve conflicting objectives. The object of Jamaica's generous programme of incentives in favour of the export-oriented industries was mainly to increase employment; but by allowing duty-free imports of raw materials and other necessary supplies, this programme has conflicted with the effects of the other programme of incentives which was designed to encourage import-substituting industries.

21. These few examples of possible conflicts between the incentive measures and major industrial policies as well as between the latter and the national economic policies raise two important issues: Can incentive measures be harmonized with industrial policies and national economic policies?

How does one make the necessary adjustments to reconcile conflicts which arise between national economic objectives, industrial development objectives, and within these - the objectives of incentive measures?

#### B. The role of incentive policies

22. The role of incentive measures can be considered under three headings:

- (i) their relationship to industrial policy objectives;
- (ii) their role in the dynamic setting of the process of economic development; and
- (iii) limits to the scope and effectiveness of incentive measures.

#### (i) Relationship to industrial policy objectives

23. The role of incentive measures can be considered in relationship to the objectives established for the industrial sector. First of all there is the general aspect; this raises the issue: What role can a package of incentive measures play in helping to achieve the quantitative target set for private investment in the industrial sector? In other words, what role can incentive measures play in assuring that a sufficient volume of financial and other resources are mobilized and channelled into investment in the industrial sector?

24. Besides this more general role, incentive measures may be used to promote investment in selected industrial projects which the Government wishes to see implemented. The issue arises: Are incentive measures an appropriate way of directing private investment into certain industries or certain projects? This issue is discussed in more detail in the Issue Paper on Criteria for selecting industries benefitting from incentive measures (ID/WG/30/11).

25. Incentive measures are also used to encourage new enterprises to locate in industrially less-developed regions of the country. The issue arises: Are incentive measures an appropriate way of achieving this objective? Can they compensate enterprises for the additional costs involved in meeting the Government's wishes as to location?

26. Finally, incentive measures have been used to encourage a higher volume of exports of manufactured goods. In some cases the incentive has taken the form of providing additional encouragement for export-oriented industries; but more frequently it has been based on making the exporting process itself more profitable. The issue arises: Are incentive measures an appropriate way of achieving this objective?

(ii) The relationship between incentive measures, industrial policies and national economic policies in a dynamic setting

27. It is generally recognized that industrialization is a dynamic process. Therefore, the issue arises: Should not the relationship between incentive measures, industrial policies and national economic policies be reviewed in the context of a dynamic evaluation of the industrialization of the country?

28. The dynamic analysis raises the question: is there any relationship between the package incentive measures used and the stage of industrialization of the country? Some people believe that the package of incentive measures must be formulated taking into account the stage of industrialization of the country. Therefore, the issue arises: Does the package of incentive measures need to be reviewed and adjusted periodically in the light of the progress of industrialization of the country?

How could such a review be approached and what criteria can be used to make such a review? This issue will be discussed in

more detail in the Issue Paper Formulating a Programme of Incentive Measures (ID/WG/30/10).

29. The dynamic nature of incentive measures raises a further general issue: How can the relationship between incentive measures and industrial policies be adapted to changing national economic circumstances and resulting changes in national economic policy objectives.

(iii) Limits to the scope and effectiveness of incentive measures

30. What can incentive measures be expected to achieve and what results should one not expect them to achieve?

31. The country papers suggest that a number of countries have formulated a well-conceived package of incentive measures and made adequate arrangements for their implementation. However, despite their availability, the rate of growth of the industrial sector has remained below the rate which these countries expected to achieve. The issue arises: Can the provision of a well-formulated set of incentive measures by itself ensure the achievement of targets set for private investment in the industrial sector? Or are other factors and conditions needed as an essential pre-condition for the incentive measures to secure the contribution from the private sector to industrial development.

32. The Country Background papers stress that the success of incentive measures should not be evaluated simply on the basis of the criteria: (a) that an appropriate package of incentives has been formulated and (b) that adequate machinery for their implementation has been developed. The Papers emphasise that many additional factors determine whether a desired level of investment in industry is realized or not, and conclude that the effectiveness of incentive measures cannot be evaluated in isolation, that is without considering these other factors. The issue arises:

What are these other factors? Should they be considered as an essential pre-requisite for incentive measures to play their full role?





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