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IMPORT DUTY CONCESSIONS AS AN INCENTIVE MEASURE

Issues for discussion

"Remission of import duties is generally thought to be of greater potential value to most manufacturing businesses than income tax concessions."

George Lent: Tax Incentives for Investment

I. INTRODUCTION - THE PROBLEM

Import duty concessions are one of several types of incentive measure which can be used to enhance the potential profitability of a new industrial project. Where import duties are levied on imports of machinery and equipment, they can serve to reduce the capital cost of a project. Where concessions are also granted on the duties levied on imported raw materials and supplies, they serve to reduce the operating costs of the project.

2. The problem raised in this paper is "are such concessions an appropriate way of introducing incentives"; or can the tariff structure for these categories of imports best be brought into line with the Government's desire to encourage new industrial projects and provide them with a favourable cost structure by a general and non-discriminatory revision of the tariff structure?

II. REVIEW OF ISSUES

3. A range of issues arises when considering this problem. This section lists as many as possible under the following headings:

(A) Why are import duty concessions needed?

(B) If they are needed, should they be granted on a non-selective or selective basis? If granted on a selective basis, what criteria should be used?

(C) Do import duty concessions conflict with other industrial policy objectives?

A. Are import duty concessions needed?

4. Exemptions or reductions of import duties are granted for some or all of the following categories of imports: (a) machinery and equipment; (b) raw materials; (c) intermediate goods. The issue arises are such import duty concessions necessary?

5. A simple answer is that they are only necessary if the duties levied on those categories of imports are high enough to make the concession worthwhile. The issue arises then: at what level do concessions become worthwhile; if the import duty is 5%, 10%, 15% or 20% etc?

1. Concessions on imports of machinery and equipment

6. Import duty concessions are applied to three categories of imports. Why are imports of machinery and equipment the category most frequently granted concessions? Because they reduce the capital cost of the project and reduce its total financing requirements; because there is a fear that other countries granting this concession will attract the investment; or other reasons?

7. The duration and scope of the concession granted for this category of import varies a great deal and is not always clearly defined. The issue arises: should the initial concession also apply to imports of spare parts or replacement parts needed at a later date?

2. Concessions on imports of raw materials and other supplies

8. Import duty concessions are not granted so frequently for imports of raw materials and other imported supplies, e.g. component parts. In almost every case, such concessions are restricted to categories of goods where there is no local production or sufficient local supplies are not available. In Ecuador's legislation, this exemption is made subject to a regular annual review to ensure that local materials are used as soon as they become available.

9. The issue arises: Is there any economic logic in granting this type of concession for imports of raw materials? Is it because the Government wishes to provide a form of continuing incentive; because this concession helps reduce manufacturing costs; or other reasons? Why should enterprises which are expected to do without this concession after a period of years need it in the initial operating period?

10. Is there any economic logic in extending the concession granted for imports of raw materials to other imported supplies - such as component parts?

11. When import duties on those categories of imports are high, relief from these duties can result in a significant reduction in manufacturing costs. This raises further issues: Does the incentive legislation always ensure

that these reductions are passed on to the consumer? The relevant law in Nigeria provides that relief from import duties on raw materials is granted only if the enterprise can prove that it would otherwise be unable to produce the end product at prices competitive with the prices of comparable imported goods or at prices which would ensure that an adequate market in Nigeria could be found.

12. A further general issue can be considered here: should import duty concessions on raw materials and other supplies take account of the level of protection established for the finished product? This has not always been the case. Several Country Background Papers point out that the combination of tariff protection and import duty concessions provides unduly favourable manufacturing conditions for some enterprises.

B. Should concessions be granted on a non-selective or selective basis?

13. There are two approaches used for selecting qualifying industries. The first approach distinguishes between (a) imports required for incorporation in goods subsequently exported and (b) imports used for goods sold on the local market. The second approach singles out priority industrial projects and grants import duty concessions only to those projects.

(a) Concessions granted to promote exports of manufactured goods

14. The first type of selective approach is used by many of the industrially advanced countries as well as an increasing number of developing countries. Given that the export of manufactured products is a national economic goal, the main disadvantage is the cost and effort involved in administering this type of measure. The main issue arising in implementing this approach therefore is: what system should be used? the duty draw-back approach; more general forms of import duty exemptions for export-oriented industries; duty-free manufacturing zones?

(b) Concessions granted to promote priority industrial projects

15. The second approach is more contraversial since it creates a more favourable cost structure for the benefitting projects and not other projects. The issue can be considered in the following way: should incentives be applied in this form which affects the cost structure and hence the enterprise's ability to establish competitive selling prices, or in a measure like tax incentives which does not?

16. A further factor to be considered when formulating import duty concessions on a selective basis is the effort and cost involved in implementing them and the danger of abuse. Concessions for imports of machinery and equipment are less complex in this respect since they are a once-and-for-all transaction; imports of raw materials are implemented in a continuing series of transactions which are open to abuse.(1) The issue arises: How serious a problem is the administration of import duty concessions granted on a selective basis?

17. An interesting comment on this point is the example of Ecuador where the legislation provides that all companies benefitting from import duty concessions must pay a special tax equal to 5 per cent of the import duties foregone to cover the cost of administering this part of the incentive programme.

(c) Implications for the tariff structure

18. Import duty concessions represent an adjustment to the tariff structure. Where they are applied on such a widespread basis that they can be considered as a general concession, then the same result would be achieved by permanently modifying the tariff structure to include the concessions granted.

19. Where concessions are granted on a selective basis to promote priority industries, the issue arises: would it not be more appropriate to modify the tariff structure to achieve the same effect on a non-discriminatory basis? When Thailand eliminated concessions on imports of raw materials, it modified the tariff structure at the same time.

C. Do import duty concessions conflict with other industrial policy objectives?

20. One major conflict which arises when formulating import duty concessions is the loss of revenue. For many Governments import duties are a major source of revenue. They represented 13 per cent of Government revenue in 1963 in Mexico, about 20 per cent in Chile and Colombia, but up to 50 per cent in Costa Rica, Nicaragua and Panama.(2)

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(1) One developing country advised by a UNIDO expert found that abuse of the system was so widespread that it considered withdrawing its selective concession for raw materials and instead establishing a low rate of import duty for all imports of raw materials which would bring in the same volume of revenue.

(2) See ECLA Process of Industrial Development in Latin America, page 158

22. However, further analysis may show that the conflict arises not so much as a result of the concessions granted, but as a result of the industrialisation process itself and the Government's desire (reflected in import duty concessions) to keep the cost of locally-produced goods as low as possible. A key issue arises then: Should the cost of import duty concessions be considered as part of the cost of the incentive programme, or a cost of adapting the tariff structure to the needs of the industrialisation process itself? If the second and broader view is taken, should not the revenue generating effects of industrialisation (or at least the benefitting projects) be taken into account?(3)

23. Import duty concessions can encourage the wrong type of industrialisation if they are granted without careful scrutiny of the type of project supported. A combination of high tariff protection for the finished product and import duty concessions can encourage the development of assembly-type industries which bring profits to the enterprise but little benefit in terms of value added to the economy; frequently they also result in a considerable increase in costs to the consumer. One way to avoid the situation is to include minimum local content conditions as part of or as a supplement to the incentive legislation; India and Argentina have introduced a local content requirement which rises progressively each year for the manufacture of cars, buses, trucks, tractors, etc. Other countries (e.g. Ecuador) have established minimum local content [illegible] (4) The issue arises then: Can import duty concessions lead to the development of the wrong type of industrial project? If so, how can this be avoided?

24. Import duty concessions can discourage the search for local sources of supply and hence reduce the pressure to build up supporting local industries. Most countries limit import duty privileges to raw materials and other supplies not locally available; but only a few countries have made legal provision for following Ecuador's practice of keeping this concession under annual review. Have developing countries always paid sufficient attention to this problem in designing their incentive legislation?

25. This conflict is potentially more serious when import privileges are granted for a wide range of categories of imported goods used in exported

(3) For a careful analysis of Pakistan's experience, see Stephen R. Lewis, Jr., "Revenue Implications of Changing Industrial Structure: An Empirical Study" National Tax Journal, Vol.XX, No.4. (December 1967), pp.395-411

(4) See the Issue Paper Criteria for Selecting industries qualifying for Incentives. (ID/WG/30/11)

manufactured goods. The issue arises; Are situations likely to arise where some exporting enterprises continue to purchase import requirements from abroad when they could be purchased locally?

26. A similar conflict is also beginning to arise in those developing countries which have developed local industries to make machinery and equipment. In Argentina and India, import licensing controls have been used to ensure that firms are forced to buy local machinery as equipment when it is available at a competitive price. The local enterprise may prefer to buy abroad for many reasons; the issue arises: should import duty concessions for plant and machinery be supplemented by other measures designed to help build up a local capital goods industry? What criteria should be applied to enforce local purchases; the cif price of competing imports plus the import duty or other criteria?

III. SUGGESTED ISSUES FOR DISCUSSION

27. This paper has raised a number of issues. To maximise the value of the sessions devoted to this subject, it is suggested that discussion concentrates on the following issues. To bring out the experience of countries represented at the Seminar, participants might indicate:

(a) whether they grant full or partial import duty concessions (i) for machinery and equipment, (ii) for raw materials, (iii) for other categories of imported goods;

(b) whether their tariff structure makes these valuable concessions;

(c) how long the concessions last for each category of imports;

(d) whether these concessions have noticeably discouraged the development of local sources of supply;

(e) whether import duty concessions have led to the establishment of the wrong type of industry.

The following general issues might be discussed:

(f) Is lowering the cost structure of local industry such a worthwhile aim that import duty concessions are necessary?

(g) is there any justification for using import duty concessions (a discriminatory approach) in preference to revising the tariff structure (a non-discriminatory approach)?

(h) how can the general goal of reducing the cost-structure of new industries and encouraging local production of the imported goods [illegible] concessions be resolved?