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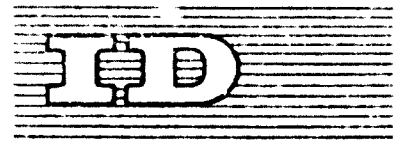
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FORMULATING A PROGRAMME OF INCENTIVE MEASURES^{1/}

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FORMULATING A PROGRAMME OF INCENTIVE MEASURES

Issues for discussion

I. INTRODUCTION - THE PROBLEM

1. The formulation of a programme of appropriate incentive policies is an art more than a science. Economic data and analysis can help the policy maker, but the formulation depends on estimating the reaction of private investors to the policies followed.
2. The process of formulating a new package of incentive measures has several elements. First, the objectives need to be defined. A choice has to be made as to whether all new industrial projects will benefit or only selected projects. The level of generosity of the incentives has to be determined and a decision made as to whether it will vary from project to project. The different types of incentive measure have to be reviewed and a decision made on which types to use in the programme and what degree of emphasis to give to each one.
3. The aim of this paper is to review the economic criteria and considerations involved in this process of formulating an appropriate programme of incentive measures.

II. SURVEY OF ISSUES RAISED

4. The issues raised in this paper can be grouped under the following headings:
 - A. Can clear objectives be outlined for a programme of incentive measures?
 - B. What range and type of industrial project require incentives?
 - C. What factors and criteria are involved in determining the generosity of the incentives to be offered?
 - D. What criteria can be used to select the most appropriate measures from the different types of incentive measures available?

A. Objectives for the programme of incentive measures

5. When modifying an existing programme of incentive measures or formulating a new programme, certain background assumptions can be used. The major consideration will be the volume of investment in industry required from the private sector and the type of industries to be established. The volume of investment will depend on the proportion of national investment required by the industrial sector, and the proportion of this total expected to be contributed by the private sector. The issue arises: how do these targets affect the scope and generosity of the required programme of incentive measures?

6. The objectives can be clarified at the macro economic level if potential sources of financing of investment in the private sector are outlined. Such an outline would show what proportion of funds can be generated by the savings of existing enterprises and what proportion of investment will have to be raised from sources outside the industrial sector. A further consideration will be what volume of funds is foreign investment expected to contribute? The issue arises: should the main emphasis of the programme of incentive measures be designed to encourage savings (i.e. the re-investment of profits by existing industrial enterprises)? or should it be to attract sources of finance outside the industrial sector?

7. If the emphasis is on attracting finance from outside the industrial sector, the issue arises: should incentive measures be designed specifically to encourage and facilitate the availability of finance in the appropriate forms?

8. Besides encouraging new investment in the industrial sector, programmes of incentive measures may have subsidiary objectives such as (a) to encourage new enterprises to locate in less-developed regions of the country, and (b) to promote a higher volume of exports of manufactured goods. The issue arises: are these objectives mutually consistent? Can the same incentive measure be used to promote more than one objective?

B. What range and type of industries require incentives

9. Depending on the stage of industrialization reached in the country, new investment will be divided between:

- (a) New industrial enterprises;
- (b) Expansion of existing industrial enterprises;
- (c) Modernisation of existing industrial enterprises.

The issue arises: are all or only some of these forms of investment to be promoted by incentive measures?

10. The scope and generosity of the programme of incentive measures will also depend on the range and type of industries which are being established. Many developing countries have found it difficult to mobilise the funds required for such capital-intensive industries as steel manufacturing. The issue arises: if such capital-intensive projects are promoted in the private sector, do they require special consideration when designing a programme of incentive measures?

11. In another Issue Paper (Criteria for Selection, Industries qualifying for Incentive Benefits ID/WG/30/11) the ways in which developing countries have selected particular industries to benefit from incentive measures are considered. The paper shows that the selection of benefitting projects has been made (a) in the form of a list of industries, or (b) on the basis of certain established economic criteria. The issue arises: what criteria should be used to decide whether to provide incentives for a project: national economic criteria or the potential profitability of the project?

12. Experience would suggest that some countries have reduced the range of industries qualifying for incentive benefits as the process of industrialization proceeded. The issue arises: how does the stage of industrialization reached affect the choice of industries benefitting from incentive measures?

13. An important objective which is often forgotten is the need to establish efficient industrial enterprises. The issue arises: what criteria can be used to determine efficiency and how do these criteria change at later stages in the industrialization process? In other words, what level of protection (25%, 50%, 100%) should be tolerated when approving new projects to benefit from incentive measures?

C. Determining the generosity of the incentives to be offered

14. The provision of incentives by a Government reflects its desire to see certain industries established. Incentives are only needed if these projects do not appear sufficiently profitable in the light of the risks involved for private investors to undertake them.

15. Many developing countries provide incentives of a uniform level of generosity to all benefitting types of project. However, the potential profitability of a project for the private investors sponsoring it may well vary from one branch of industry to another. The issue arises therefore. is it necessary to provide incentives of different levels of generosity?

16. Where the programme of incentive measures is selective (a) in the type of projects supported, and (b) in the generosity of incentives granted to the project, considerable discretion can be left to those administering the programme of incentive measures. The issue arises: how can this element of discretion be reduced? (This issue is discussed further in the Issue Papers ID/WG.30/11 and ID/WG.30/12).

17. Some countries have established categories of industries which are granted incentives of different levels of generosity. Other countries have varied the generosity according to certain economic criteria such as the projects contribution in terms of value added within the country. The issue arises: are these a useful way of introducing a flexibility into the programme of incentive measures without leaving too much discretion to those administering it?

D. Selecting the different types of incentive measure to use

(i) Introduction

18. Seven different types of incentive measure have been considered at this Seminar. In addition, direct forms of subsidy or grant to an industrial enterprise might also be considered, although such a form of incentive does not require an Issue Paper to consider the problems involved in its design and implementation.

19. In the seven Issue Papers which consider different types of incentive measure, a number of important considerations were raised. The purpose of this section of the paper is to gather these together and suggest ways in which some incentive measures can be selected for inclusion in the programme of incentive measures and others can be rejected.

(ii) Removing obstacles

20. Given that the main objective of most programmes of incentive measure is to promote the achievement of a given level of private investment in the industrial sector, it will be important to review past performance in this respect and to identify any particular obstacles. Where obstacles or disincentives can be identified, the different types of incentive measure which can remove these obstacles will clearly require special consideration in formulating a new or modified programme of incentive measures.

21. Three types of incentive measure rely for their incentive effect chiefly on their ability to remove obstacles which might otherwise deter the implementation of industrial projects by private investors. They are: Assistance at the pre-investment stage; Assistance with land and factory buildings; and Assistance with the development of labour skills.

(iii) Effectiveness

22. The incentive effect of the **other** different types of incentive measure considered depends ^{mainly} on their effect on the potential profitability of the benefitting project in the eyes of the investor. Can this be measured?

23. The strength of the effect will depend not only on the type of measure chosen but also on the degree of generosity with which it is implemented. Nevertheless, certain economic criteria **for choosing** between different measures can be considered.

24. Tariffs and other forms of protection, import duty concessions, and the provision of financing on favourable terms all have a direct bearing on the potential profitability of a project. The effect of tax incentives in certain forms depends on the level of profits realized by the enterprise. The issue arises: is the potential investor's decision more strongly influenced by the level of profits he is likely to make, or by concessions which will reduce his tax liability?

(iv) The cost to the Government

25. When formulating a programme of incentive measures, it is important to consider the cost to the Government of the over-all package. Of the seven types of incentive measure considered, six result in a direct cost to the Government either in the form of expenditure or in the form of revenue foregone. The seventh measure — Tariff Protection — need not necessarily result in a cost to the Government, instead, the enhanced profitability of the enterprise will be paid for in terms of higher prices charged to the consumer.

26. The issue arises: can a table which compares the anticipated cost of each new individual measure help in formulating an appropriate programme of incentive measures?

(v) Costs of administering the measure

27. Incentive measures which are easy to understand and simple to administer are usually the most effective. Some measures, for example import duty concessions on raw materials, result in considerable administrative costs and efforts. The issue arises: should measures which are complicated or costly to administer be ruled out from a modified programme of incentive measures?

(vi) Removing conflicts with other policy measures

28. Once a provisional selection of the different types of incentive measure to use has been made, the programme can be checked to see whether it will have results which conflict with other industrial policy objectives. For example, tariff protection, if granted on an excessive basis, may conflict with the goal of establishing internationally competitive industries. The granting of import duty concessions on a selective basis to new but not existing enterprises manufacturing the same product may conflict with the objective of fair rules of competition. The issue arises: should these and similar conflicts be eliminated by excluding the type of incentive measures involved from the programme?

III. SUGGESTED ISSUES FOR DISCUSSION

29. A number of issues have been raised in this paper but the subject matter is a difficult one to discuss in terms of issues. Instead, participants will be asked to comment on the approach suggested in this paper.





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