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GOVERNMENTAL ASSISTANCE IN ESTABLISHING INDUSTRIAL PROJECTS IN THE PRIVATE SECTOR

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The Governments of several under-developed countries are seeking to promote industrialisation through private enterprise. For this purpose, it is usual to grant concessions and incentives of various types with a view to assisting private enterprise in gaining strength and to smoothening the difficulties encountered by them. In pursuit of its objective of industrialisation within the framework of private enterprise system, Pakistan has also experimented with a variety of such measures and acquired much first-hand knowledge. The following paper seeks to present some of the salient lessons based on Pakistan's experience in this connection.

1- It is now recognised that economic development can not be brought about by merely injecting in the economy the various physical factors of development. On the contrary conditions must be first created which encourage and are conducive to economic growth. In other words, a healthy investment climate has to be created.

The first requisite for creating an active investment climate for private investment is the formulation of a balanced and enlightened industrial policy, providing freedom to private enterprise and assuring them safety of capital, enjoyment of rewards and control on enterprises. It is Pakistan's experience that the maximum possible freedom and safety should be provided. Often it is stated that development through private enterprise may be too time-consuming due to its lack of resources and experience. However, these handicaps are applicable in the case of governments as well. For historical reasons, the concern of governments with problems of economic development has been minimal so that they are hardly in a better position than the private entrepreneurs. While there may be industries whose development in the public sector may be desirable for one reason or the other, a high rate of industrial development would be achieved only if private enterprise is afforded maximum freedom.

It is well known that in the initial stages of development a protective tariff policy is essential. Industries set up by private enterprise may not be profitable if they are to face competition from low cost imports from advanced countries enjoying economies of scale, a high level of technological development and other advantages. In the under-developed countries, due to lack of domestic capacity, tastes may have been established for imported products, with the result that even when the indigenous product is competitive in price and quality, it may not find market. The advantages of imported articles could conceivably be strengthened by unconscious incongruities in tariff structure, such as, high tariff on raw materials and lower tariff on finished products based on these raw materials. In these circumstances, protection is definitely called for. However, the need and extent of protection should be viewed in its proper perspective. It appears that the claims of protection are often pressed too far. With generally strict exchange controls and import licensing in most under-developed countries, an element of protection already exists. In these circumstances, over-protection is liable to lead to inefficiencies, high prices and hardships to consumers. Pakistan's experience suggests that the protection policy should be conservative and cautious. In granting protection, preference should be given to industries based mainly on local raw materials and enjoying sizable local demand so that at a relatively early date these could stand on their own feet. Protection would also be merited in the case of industries based to some extent on imported raw materials but having a large domestic and / or export market. In the case of industries based mainly on imported raw materials, the claim for protection should be critically scrutinised. Imports in such cases are often more desirable than setting up expensive industries which would require an inordinately long period of nursing and contribute to higher costs all round.

The scope of commercial policy in under-developed countries is often restricted to protection only. Commercial policy is capable of playing a wider role in the encouragement of industrialisation in the private sector. For example, it could be used for encouraging exports of industrial products. In so far as measures of export promotion are successful, a wider market would be created for the industries which would spur their development further. Pakistan has made use of export incentives with good results. Since 1959, an Export Bonus Scheme has been introduced under which exporters of a fairly broad range of manufactured items are allowed import licences, known as Bonus Vouchers, equal to 20-30% of the FOB value of exports. The vouchers are transferable in the open market and sell at a premium of about 150% . This has proved of considerable benefit to industrial growth in the private sector.

In most under-developed countries, imports of raw materials and capital goods for industries are subject to strict licensing. Another aim of commercial policy could be to reduce this dependence, and additionally to introduce an element of flexibility in licensing procedures. In Pakistan this is partly achieved through the Bonus Scheme under which several industries are required to import a part of their raw material requirements, outside normal licences against bonus vouchers only. In the case of export industries import licences for raw materials are issued on an advance basis in anticipation of exports subject to repayment of foreign exchange involved in due course. Finally, new types of import licences have been introduced under which industrialists are entitled to import their requirements as soon as they can prove that previously imported raw materials have been used up properly.

The industrial investment climate is vitally affected by the rates and type of taxation. A very high level of direct tax impairs incentives towards efficiency, high production and desire to work and should, therefore, be avoided. If investment in industries are to be stimulated, then some fiscal incentives would also be necessary, apart from reasonable tax rates. These incentives may take the form of development rebates, accelerated depreciation, carry-forward of losses during the first few years, total or partial exemption from tax on reinvested profits, etc. As in tariffs, over-liberal fiscal concessions are not to be recommended. There are several reasons for this. Firstly, these may generate a sense of false complacency and inefficiency. Secondly, undue concentration of wealth may occur. Thirdly, these may come to be reckoned as crutches and it may not be easy to wean the industries away from them. In such circumstances, fiscal incentives instead of being beneficial to the recipients may redound to their disadvantage. A careful watch is desirable to ensure that fiscal incentives are really needed and are not continued longer than necessary. As soon as a sizable class of industrial entrepreneurs has emerged, the endeavour should be to reduce the extent of fiscal concessions. As to how long will it take to reach this stage would depend on conditions in individual countries. In the case of Pakistan, it took nearly 15 years to reach this stage.

The needed rationalisation of tax structure can be achieved in many ways. A gradual shift may be effected from "blanket" to specific tax concessions so that (i) only industries considered essential and desirable are encouraged; and (ii) industrialisation of backward areas is expedited. Further, industrial companies whose ownership is diffused may be subjected to lower income tax compared to those with a narrow ownership base. Finally, consideration may be given to introducing wealth tax, capital gains tax and estate duty. It may be remarked that the dilution of fiscal incentives would undoubtedly have some adverse effects but with proper planning these could be checked. In so far as these measures promote sound industrialisation, wider distribution of wealth and enlargement of market, the long-term effects on private enterprise would be beneficial.

A sound monetary policy is also necessary for creation of a healthy industrial investment climate. Broadly speaking, a policy emphasising price stability while at the same time ensuring that genuine credit requirements are met in full is to be preferred. There may also be need for strengthening the institutional framework by establishing government-owned and operated banks. The interest policy also deserves attention. On the one hand it should not be too high as to impede genuine investment and on the other it should not be too low to adversely affect savings, encourage mushroom industrialisation and lead to misuse of resources. An obstacle to financing industries in the private sector is frequently the inadequacy of private savings. It is sometimes suggested that this deficiency may be met through liberal credits by banks with the Central Bank's support. Our experience has been that mere credit expansion can not promote private investments. Credit is not a substitute for savings and while it may give command over real resources, it can not generate them. It is only through an act of saving that resources can be released from current consumption and devoted to capital formation. Credit expansion in excess of genuine savings will only lead to competitive bidding for resources and harmful inflation.

A developing economy is likely to be characterised by scarcities and shortages of various kinds. In view of this, controls on consumption, price and distribution may be inevitable. In so far as controls lead to allocation of resources in line with planned priorities, hold down inflationary pressures and contribute to equitable distribution of limited supplies, these are quite useful. However, controls have a tendency to multiply; they lead to administrative problems, create structural disturbances in the economy and discourage production. The proliferation of controls is also inimical to the freedom of private enterprise. It is, therefore, necessary that controls are enforced to a minimum and withdrawn as soon as they have served their purpose. In Pakistan, prior to 1958, there was a wide complex of controls, which adversely affected industrial development. Since then a gradual policy of decontrol has been introduced which has perceptibly strengthened the industrial investment climate. A notable example of this is the sugar industry. Beginning from 1961-62 season, a policy of partial decontrol was introduced under which sugar mills were required to surrender to Government, instead of 100% output, a gradually declining portion of their output. The rest could be sold in the free market. As a result, there was a sharp increase in production. Consumers and agriculturists both benefitted, the former because of improved availability of sugar and the latter because of ~~in~~ enlarged demand for their cane. At the same time, the period since 1961-62 season has witnessed record growth of private investment in the sugar industry.

Another important lesson emerging from Pakistan's experience is the crucial importance of agriculture for the creation of healthy industrial investment climate. This needs to be emphasised because in a developing economy preoccupied with industrialisation, there is a real danger of downgrading of the importance of agriculture. This could have serious consequences as it is difficult to visualise a healthy industrial sector coexisting with agricultural backwardness.

This is on account of the inter-relationship between agricultural and industrial development. In the first place, a rise in agricultural productivity enables the agricultural sector to meet the increasing requirements of agricultural products of the urban population and the industrial sector. Secondly, it raises agricultural incomes, thereby assuring an expanding market for the products of domestic industry. Thirdly, it enables agriculture to provide major wage-goods of workers employed in industry at prices favourable to the profitability of new industry. Finally, a rapid rise in agricultural production contributes to foreign exchange earnings of the country thereby making it easier to finance the industrial development program. Realisation of these vital inter-relationships led to the inauguration of a policy of increased emphasis on agriculture in the Second Plan (1960-65) in Pakistan as a result of which impressive increases have been recorded, contributing to acceleration in the tempo of private industrial investments.

Industrialisation presupposes import of capital equipment which in turn is linked with availabilities of foreign exchange. As most developing countries are generally short of foreign exchange, inflow of foreign capital can make a vital contribution to bridging this deficiency and also provide much needed technical skills and experience. Every effort should, therefore, be made to attract foreign capital. Some measures that can be taken in this connection are assuring freedom of repatriation of capital, remittance of earnings, fair compensation in the event of nationalisation, avoidance of double taxation, inter-country investment treaties and agreed arbitration arrangements. Pakistan's experience is that inspite of such incentives foreign private capital inflow may still be tardy. Main reliance may therefore have to be placed on inter-government loans, at least until such time that the supply of foreign capital on a voluntary basis improves sufficiently. The shortage of technical skills in the absence of voluntary inflow of foreign capital should be sought to be met by acquisition of patents, employment of foreigners, turnkey agreements, etc.

2- It is unlikely that industrialisation through private enterprise can be promoted by measures designed to create a suitable investment climate alone. These must be supplemented by measures of immediate impact and specific assistance to private enterprise. This is warranted on grounds of urgency of economic development, weakness and inexperience of private enterprise, technological backwardness and inadequacy of capital resources.

Amongst the various steps that can be taken in this connection, highest priority should be given to the establishment of development banks. A development bank can render vital assistance to private industrialists in several ways. Firstly, by providing long term finance through equity and loans, it can help in the removal of a serious bottleneck in the development of industries. Secondly, development banks can help in the improvement of quality of industrialisation through their well-known projects appraisal techniques. This will make for the success of the enterprise, optimum utilisation of country's scarce capital resources and also help to educate the industrialists in the modern investment procedures. Thirdly, due to their emphasis on sound industrialisation, they will help in the mobilisation of domestic and foreign resources as very often industrial development is held up not so much for want of resources but for lack of suitable bankable projects. Fourthly, the development banks can assist in the growth of capital market through increasing the supply of quality scrips, by timely under-writing assistance and rotation of their equity investment after nursing the infant projects in their teething stages. Fifthly, by assiduous promotional efforts they can open up new and profitable fields of investments. However, if the development banks are to be successful in their task, certain assistance should be provided to them by Government. In the beginning it may be difficult for them to mobilise sufficient resources through their own efforts. Consequently, substantial government financial help would be required. Another lesson derived from Pakistani experience is that the government should also provide them with resources in foreign currencies to meet the private industrialists' requirements of import of capital equipment. In fact possibility should be examined of routing the foreign exchange resources meant for the setting up of industries, in the private sector mainly, if not exclusively, through them. Development banks should additionally be provided assistance to become strong institutions through the grant of special tax concessions. The margin between the rate of interest paid and charged by them should be large enough and not artificially kept below economic levels. Finally, in case of there being more than one development bank, it is advisable to demarcate their fields of activity and even clientele by size of loan to prevent over-lapping and undue competition.

Conceivably there may be sectors of industries where, even with the support of development banks, private entrepreneurs may still not be interested due to heavy size of investment, poor profit prospects and large risks. Lack of interest could also originate from marketing hazards. In these circumstances, it would be desirable that a special development corporation is established by government to undertake such ventures and manage them until these are strong enough to stand on their own and could be sold to private industrialists. It is important that the mandate for disinvestment by government corporation should be clear and firm for there is often a tendency to avoid transfer to the private sector. Such tendencies should be resisted, if the policy of encouragement of private enterprise is to be successful.

Planning is popular with many of the under-developed countries which usually bring out a National Economic Plan periodically. A measure of help to the private industrialists may be the publication of an Industrial Investment Schedule to spell out the fine points of this plan. National plans are usually couched in broad terms and are not by themselves of help to entrepreneurs in locating worthwhile and profitable industries. It is doubtful whether the entrepreneurs would have the ability to undertake this exercise by themselves. In these circumstances, an investment schedule listing industrial priorities and issued as supplementary document to the plan can be of help. Such a schedule has been introduced in Pakistan since 1960. It gives investment ceilings in as many as 184 industries. The total in the schedule corresponds to the Plan's industrial investment target. Utilisation or sanctions against the provision in the schedule are regularly debited. Besides helping private industrialists in picking up investment opportunities, it aids in the diversification of investments and keeps them in step in different sectors. Excess or under capacity for lack of forward and backward linkage of investments is thus avoided. It also reduces red tape in as much as provision for an industry in the schedule is indicative of government sanction for investment in that industry. An industrialist can proceed with his project within its limits unencumbered with any other restriction; issuance of import licences and other permissions is also facilitated. Pakistan's experience shows that the value of a schedule would be impaired unless certain measures are taken. Firstly, the monetary limits in the schedule should not be inflexible. These should be open to revision if circumstances so warrant. Secondly, the inclusion of an industry in the schedule should not commit the development bank to financing it. Instead the development bank should have full freedom to pick and choose among the various industries. Thirdly, the provision in the schedule should be unencumbered as far as possible from any restrictions on its utilisation.

Another help to private enterprise could be in the form of pre-investment advice. If the project is to be successful it must be based on a thorough examination of the merits of the project with regard to its commercial, economic and engineering feasibility. This must be undertaken by competent consultants. In the under-developed countries such consultants are too few and also consultancy services are expensive. Although the employment of consultants can not for this reason be ruled out, nevertheless, it would be worthwhile to have the project investigated summarily as to whether it has merit enough to justify the expense of consultancy services. This sort of pre-investment check can of course be carried out by the sponsor himself. However, an exercise of this nature undertaken by him may be lacking in credence in view of his inadequate technical know-how and objectivity. The establishment of an Industrial Advisory Centre giving competent pre-investment advice is therefore desirable. Pakistan has recently established such a centre with the US (AID) assistance. Experience shows that its operations must be financed initially by Government as entrepreneurs are unwilling to bear the full expenses. Also the development banks in the country should be associated with it rather closely. This is because the objective of pre-investment study would be the establishment of industries presumably with the bank's assistance. If a project supported by the Centre is rejected by it, the result would be frustration and lack of inclination on the part of entrepreneurs to avail of its (the Centre's) facilities.

Finally, consideration should be given to establishment of investment centres in foreign countries to bring together local and foreign entrepreneurs. An important deterrent to foreign investments is unawareness of local conditions. The gaps in knowledge may relate to government policy, rules and regulations about foreign capital, taxation, and exchange controls. Besides these, the foreign investor may like to have data on specific industries, such as, target of capacity, installed capacity, current production, raw material availability, power and other facilities. Foreign joint ventures may also be hindered for lack of knowledge about the prospective collaborators, their financial status, technical experience and marketing network. Investment centres in foreign countries could supply the information and thus lead to a greater inflow of foreign capital. Pakistan has 3 such centres at London, New York and Frankfurt. The work of these centres are supervised and coordinated by an Investment Promotion Bureau in Pakistan. These centres have proved valuable in serving as clearing house for information and as meeting points for foreign and local industrialists.

3- The above is by no means an exhaustive list of measures that can be taken by Government to help private enterprise in furthering industrial development. The scope of assistance is fairly large. Pakistan's experience is that private enterprise could play a vital role in industrialisation, provided appropriate assistance is made available.

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