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REGIONAL DEVELOPMENT POLICY:
AN INTERNATIONAL SURVEY OF INCENTIVE SCHEMES

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REGIONAL DEVELOPMENT POLICY :

An international survey of incentive schemes

- K. Ramachandran

Attempts to industrialise less developed regions have gained importance in both poor and advanced countries, especially in recent years. The nature and type of the incentives offered to attract industrial investment to such designated backward areas vary from country to country. This is, to a great extent dependent on the economic and socio-political environment prevailing in these countries. The attempt in this paper is to briefly survey the regional incentive schemes in fiftyfive countries and to explain the broad patterns emerging out of it.

In the case of backward area development, incentives are intended to compensate for the extra costs incurred or benefits foregone by setting up business in a backward area, instead of in a developed area. In that sense they are gap fillers, and they can be linked to input factors by reducing their costs or linked to outputs by increasing their price. Subsidised input costs are, however, the most widely used incentives. This was amply demonstrated by a survey of regional incentive schemes in 55 countries all over the world, and discussed below, where it was found that only 2 have schemes to subsidise output. This survey was based on relevant literature available and on responses to enquiries from 15 countries. This does not represent a stratified sample, but covers most of the large countries in the world. These incentives are meant to encourage location

of businesses in less developed regions; in some cases, however, small scale enterprises are given special preferences. The incentives studied can be classified into fiscal, financial and physical, with sub-classifications.

Fiscal Incentives

As shown in Table 1, fiscal incentives can be classified into those on capital, labour and other inputs, on outputs and on profits.

Accelerated depreciation and investment allowances on fixed assets are the most widely used incentives on capital. For instance, in parts of Israel, machinery and equipment can be completely written off in four years and industrial buildings in five years, using the straight line method of depreciation. Ireland offers firms investing in specified regions an additional investment allowance of 20 percent in addition to the normal 100 percent depreciation allowance.

The investments eligible for capital incentives vary from scheme to scheme, but broadly cover investments in plant, machinery and industrial buildings. Occasionally they are confined to domestically produced assets as in Mexico, or are offered at more favourable rates than elsewhere as in Malaysia. Incentives in South Africa and Ireland cover access roads to industrial premises and power supply.

Fiscal incentives on the use of labour are not popular. In fact, only two countries among the 55 studied here have such schemes. While Israel exempts firms in specified regions from paying employer's tax, New South Wales in Australia has a pay-roll tax rebate scheme for firms locating in specified growth areas.

There are a few incentives linked to other input costs. For instance, complete or partial exemption from registration and capitalisation taxes is offered in Cameroon, Indonesia, Korea, Paraguay and Peru. Other schemes belonging to this group are the immovable property acquisition tax in Japan and fiscal licenses in Paraguay. In the same category can be considered depreciation allowances on expenditure incurred on scientific research and technology development in Canada, and import duty reduction or exemption on raw materials, plant and machinery in Brazil and Israel. In Thailand, 200 percent write-off of revenue expenditure on transport, electricity and water is permitted. Another incentive is exemption from social security tax payable by employees in the South of Italy.

Fiscal incentives on output are generally in the form of output tax deductions such as complete exemption from production taxes as in Uruguay and sales tax as in Thailand.

Deductions on profits tax are one of the most widely used regional incentives. Many countries offer complete or partial exemption from corporation tax for different lengths of time. For instance, partial exemption is offered in Cameroon, India and Italy, whereas complete exemption for 5 to 10 years is offered in Israel, Pakistan and Malaysia.

Financial Incentives

These incentives are mainly in the form of capital grants and subsidised loans. Incentives are offered for the acquisition of fixed assets and for expenditure on training, employment, research and modernisation.

Investment grants (otherwise called capital grants) are offered as a percentage of investment expenditure on plant and machinery, and industrial buildings. Most industrial market economies, and some less developed countries such as India have capital grant schemes. Eligibility for this incentive is fixed automatically or through negotiation, with countries such as Italy offering grants up to 50 percent of the fixed investment cost. In some countries, for instance in India, less developed regions are classified into three, each eligible for a different rate of capital grant. In Sweden grants also cover working capital. Firms in Greece have to invest a minimum percentage of project cost as fixed capital to be eligible for capital grant. Countries such as the UK have both discretionary and automatic grant schemes, and firms can be eligible for both.

In the category of 'other financial incentives', many countries have soft loan schemes as in India, Japan and the United States. In Italy loans are subsidised to the extent of 30 percent of the official rate, repayable in fifteen years. Victoria in Australia has a graduated loans subsidy scheme starting with 75 percent in the first year, and tapering off in the sixth year. In Turkey, a minimum equity capital of 30 percent of total investment is required to make a firm eligible for subsidised loan. In Greece, the stipulation is a minimum number of jobs created.

There are many incentives related to employment. One of them is training grants. These can be either a certain fixed or graduated percentage of the employer's wage bill as in Chile and Ireland, or a fixed amount per job as in France, or even a flexible amount per job as in South Africa. In Finland, both employment and training grants are paid to employers as a single amount.

In some countries such as Italy, subsidising half the fixed expenditure on research and development is linked to employing at least 25 researchers. In countries such as South Africa where industrial relocation is encouraged, very often the package of incentives includes the cost of moving personnel.

Physical Incentives

Some countries provide physical incentives in the form of subsidised industrial land and buildings. Land may be supplied at low prices as in Denmark or building rents may be subsidised as in Britain. In some places, utilities such as power and water are subsidised (for instance, in Italy and Western Samoa), and in some others transport (India). There are schemes to subsidise consultancy services in Australia and Canada. In order to help firms in marketing, there are schemes giving price advantage to firms in less developed areas (for instance, in Australia, Italy, Norway and South Africa).

The above discussion has shown the diversity of incentive schemes that are used in different countries. Although the information is limited, it is possible to make some observations based on the contents of Table 1.

Table 1

Incentives in Fiftyfive Countries

Income category*	Fiscal				Financial		Physical
	Cap	Lab	Out	Prof	Grant	Others	
Lowest Income Group							
Botswana	*						
India				*	*	*	*
Pakistan				*			
Sri Lanka		*	*	*			

Income category*.	Fiscal				Financial		Physical
	Cap	Lab	Out	Prof.	Grant	Others	
Tanzania						*	*
West Samoa	*		*				*
Sub-total	2	1	2	3	1	2	3
Lower Middle Income group							
Bolivia	*	*		*			
Cameroon	*	*	*	*			
Columbia		*		*			
Ecuador		*					
Guatemala		*		*			
Honduras		*		*			
Indonesia	*	*	*	*			
Kenya	*						
Morocco				*			
Nigeria				*			*
Papua New Guinea	*						
Paraguay		*		*			
Peru		*		*		*	
Philippines	*	*	*				*
Thailand		*	*	*			
Turkey	*					*	
Sub-total	7	11	4	11	-	2	2

Income category*	Fiscal				Financial		Physical
	Cap	Lab	Our	Prof.	Grant	Others	
Upper Middle Income Group							
Argentina	*						
Brazil		*		*			
Chile	*	*	*	*	*	*	
Greece	*	*	*	*	*	*	
Iran	*			*			
Israel	*	*		*	*	*	
South Korea	*	*					*
Malaysia	*			*			
Mexico	*						
Panama	*			*			
Portugal	*						
South Africa	*				*	*	*
Uruguay		*	*				*
Venezuela				*			
Sub-total	11	6	3	8	4	4	3
Rich Industrial Economies							
Australia	*	*				*	*
Austria	*	*			*	*	
Belgium	*	*			*	*	
Canada	*	*			*	*	*
Denmark	*				*	*	*
Finland	*	*	*		*	*	*
France	*	*		*	*	*	
West Germany	*		*	*	*	*	

Income category*	Fiscal				Financial		Physical
	Cap	Lab	Our	Prof.	Grant	Others	
Ireland	*				*	*	*
Italy	*	*		*	*	*	*
Japan	*	*				*	
Netherlands	*					*	*
New Zealand	*				*		
Norway	*				*	*	*
Spain	*	*	*	*	*	*	
Sweden	*				*	*	
Switzerland	*					*	
United Kingdom		*			*		*
United States	*				*	*	
Sub-total	18	10	3	4	15	17	9
Total	38	28	12	26	20	25	17

Cap = Capital   Lab = Labour   Out = Output
Prof = Profit   Oths = Others

* Countries are classified into different groups on the pattern of the World Development Report

Source: Modi (1982), Table 1; OECD (1979, 1983), Various tables; Yuill (1982), Table 1.4; Mail Survey.

Some Observations

The widespread use of incentives as a tool for regional development is an indication of the importance countries attach to their regional problems. Both poor and rich countries have disparities in income between regions, and they often use the same strategies in their attempts to improve them.

The existence of regional problems in both rich and poor, and agrarian and industrialised countries suggests that regional disparities cannot be solved easily. In the absence of detailed information, it is not possible to comment on the appropriateness of these incentives to encourage firm location in specified areas. It may be noted that regional problems still exist in the UK even after having a regional policy for over half a century. This suggests that in the first place, incentives should be appropriate, and secondly, all regional problems may not be solved by incentives alone. Interventionist policies on the lines of regional incentives may act as a check on the polarisation effects of market forces, but are not the complete answer to the problem.

Apart from the 10 countries which have only one scheme under the sub-classification, the remaining 45 countries have at least 2 each, and 20 countries have at least four schemes each. This shows that most countries have adopted a multi-pronged strategy.

An analysis of the use of the schemes in countries classified according to their level of income, as shown in Table 2, suggests that fiscal incentives are used as the major incentive in poor countries, whereas financial incentives are more important in rich countries. Closer examination shows that incentives are not used widely as a regional development tool in the lowest income group of countries. The lower middle income group shows a clear preference for fiscal to financial incentives. Most of these countries offer different types of fiscal incentives, and very few of them seem to believe that financial and physical incentives are appropriate tools for their regional development purposes.

Compared to the lower middle income group, the upper middle income group shows an increased preference for financial incentives, with some physical incentives. This increased use of financial incentives is more pronounced when the advanced industrial market economies are brought into this analysis. Physical incentives are not very widely offered in any of the four categories of countries. It is difficult to imagine that such incentives are not offered at all; it is more likely that physical incentives such as subsidised industrial estates, raw materials procurement, and marketing assistance are offered as general industrial development incentives, without discriminating between regions.

Still, there could be elements of regional preference hidden in these schemes. For instance, industrial estate building rent in less developed areas is kept constant by the Japan Regional Development Corporation to increase occupancy rate, despite the capital tied up in empty premises which pushes up the real cost (based on discussions with official of the Corporation). No detailed analysis in this direction has been attempted here for lack of information.

Table 2

Incentives at a Glance

Income category	Fiscal				Financial		Physical	No. of countries
	Cap	Lab	Out	Prof	Grant	Oths		
Lowest Income Group	2	1	2	3	1	2	3	6
Lower Middle Income Group	7	11	4	11	-	2	2	16
Upper Middle Income Group	11	6	3	8	4	4	3	14
Rich Industrial Economies	18	10	3	4	15	17	9	19
Total	38	28	12	26	20	25	17	55

Cap = Capital   Lab = Labour   Out = Output
Prof = Profit   Oths = Others

Some possible explanations on the use of incentives are given below.

(i) Incentives offered in anticipation of regional development involve high risk, and only rich countries can afford to bear such risk. Poor

countries, on the other hand, avoid this risk when they offer fiscal incentives which do not take effect until firms are actually making a profit or at least selling their products. It is not clear what percentage of new manufacturing firms generate taxable profits in their early years of operation. This writer's experience with small firms in India is that they take an average of two years before making profits, and in such cases fiscal incentives are not likely to be attractive incentives to encourage investments to specified regions.

(ii) Poor countries do not have the resources to offer expensive financial incentives such as capital grants, and physical incentives such as subsidised infrastructure and supporting schemes. Fiscal incentives are decuctions from taxes and, as such, do not involve public expenditure. Rich countries, on the other hand, have the financial resources to offer more expensive financial and physical incentives.

(iii) Advanced countries compete to offer more attractive incentives than others, and then tend to offer financial incentives because firms enjoy the benefits of such incentives quicker than under other schemes. This, in turn, reduces their risks involved in investing in less developed regions. It is to be noted that the relative importance of investment grants, as well as the maximum size of grants, has increased during recent years, for instance in Denmark, Finland and France (OECD, 1983, p. 30).

(iv) Yet another reason could be the intense competition between industrial market economy countries to attract investments. Many of them are comparable in terms of their development and infrastructure, and are only differentiated by the incentives they offer. In order to

remain in the race, other countries of the same income group have to offer similar or more attractive incentives.

The appropriateness of offering such liberal incentives to attract foreign investments is doubtful in the case of small firms because SSE owners are apparently still reluctant to move across national boundaries to locate their businesses.

This competition need not always be inter-country, but can be between regions within the same country. For instance, in the USA, incentive schemes are formulated and funded by different states and there is no federal control on inter-regional competition. As a result, many states vie with each other to attract the same investment, by offering liberal incentives. Although regional development agencies will be more aggressive in their operations, and firms stand to gain from such competition, the economy has to bear the extra cost of incentive on a project that would in any case have come up in the country.

Policy in the UK is different in that regional policies are centrally formulated and funded. Regional development agencies are allowed to use these funds to promote industries in their region. They have the freedom to offer the Selective Financial Assistance at their discretion, and this creates competition between regions to attract investments.

When such competition appears to be wasteful, the central government can interfere to bring about an understanding as it happened in the case of the location of the Nissan car factory in Sunderland.

These explanations are only indicative and not final. Any one or all of them may be sufficient to explain why fiscal incentives are predominant in poor countries, and financial incentives in rich countries. Also, it is not possible to say at this stage which of them are appropriate for small firms.

It was seen that some of the countries surveyed here have very liberal incentive schemes. Greece, Israel and South Africa from the upper middle income group, and Finland, Italy and Spain from the industrial market economies need to be considered here (Ireland, although it has many liberal schemes, is not included here as many of its incentives are not region specific). Some special features can be identified in the case of these countries. Both Israel and South Africa are politically sensitive, though for different reasons, and any investment there involves high risks. It may be to compensate for these risks that very liberal incentives are offered in the countries. The schemes in Israel and South Africa are primarily intended for foreign investors as the political sensitivity applies to them much more than their own nationals. In that sense, these incentives are not intended to promote small firms.

The other four countries are in Europe, and except for Finland, all the others are members of the European Economic Community, and are geographically situated among the rich countries in the world. They have to offer very liberal incentives to compete with other richer and more central countries in order to attract industrial investment to their less developed peripheral regions. These investments can come from within the economy or outside. The element of competition is more keenly felt because of the free flow of capital within the European Economic Community members.

This survey has two limitations. First, no attempt has been made here to evaluate the effectiveness of any of the schemes since the information is based on publicity material and little evaluation of their results has been published. Second, the types of regions which are eligible for the incentives have not been discussed. This is no more than a brief survey of the types of incentive schemes that are offered in different countries.

Conclusion

This paper has shown the diversity in characteristics of the incentive schemes with some commonalities for countries at the same level of development. It is clear that the socio-political environment influences type of incentive offered. An international survey of this nature

has the merit of outlining the broad canvass, and countries can draw lessons from the experiences of others in formulating their own policies. This could eliminate the uncertainties of ad hoc policy formulation that is often attributed to government decision making. Further research, however, is required to examine the usefulness of these schemes to particular countries concerned.

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