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## The role of investment incentives for structural transformation

A comparative analysis of investment incentives legislation in developing countries in sub-Saharan Africa, South Asia and South-East Asia

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Development  
and Investment  
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## Preface

The primary goal of the ILO is to work with member States towards achieving full and productive employment and decent work for all. This goal is elaborated in the ILO Declaration 2008 on Social Justice for a Fair Globalization,<sup>1</sup> which has been widely adopted by the international community. Comprehensive and integrated perspectives to achieve this goal are embedded in the Employment Policy Convention of 1964 (No. 122), the Global Employment Agenda (2003) and – in response to the 2008 global economic crisis – the Global Jobs Pact (2009) and the conclusions of the Recurrent Discussion Reports on Employment (2010 and 2014).

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Azita Berar Awad  
Director  
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<sup>1</sup> See [http://www.ilo.org/public/english/bureau/dgo/download/dg\\_announce\\_en.pdf](http://www.ilo.org/public/english/bureau/dgo/download/dg_announce_en.pdf)

<sup>2</sup> See <http://www.ilo.org/employment>.

## **Abstract**

This study is based on comparative analysis of tax and investment legislations currently used by several sub-Saharan African, South Asian and South East Asian developing countries and on country-specific cases of financial incentives in the same regions. Based on this survey, the paper individuates common and innovative practices, and investigates the potential outcomes of specific investment incentives regulations with respect to different structural transformation and inclusive development policy goals, on different agents and at different stages of development. In particular, we examine fiscal and financial incentives in relation to five policy goals related to structural transformation and inclusive development: domestic value added augmentation, local supply chains development, promotion of quality-certified production, SMEs development, and employment generation. The expected beneficial outcomes and possible drawbacks of the examined investment incentives are presented, and a number of possible regulation improvements and supportive policies are suggested. In this way, the paper aims to offering guidance about the design of investment incentives directed at structural transformation and inclusive development goals.

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## Introduction<sup>1</sup>

Historically, successful experiences of economic development have been accompanied by processes of reallocation of economic activity and labor away from natural resource-intensive and agricultural products and low-productivity self-employment towards more complex, technology- and knowledge-intensive products and higher-productivity jobs, typically in manufacturing and services. Similarly, economic development stalemates have often been associated to the lack of effective changes in the structure of aggregate production and employment, which remained concentrated into primary unprocessed products and low-productivity self-employment activities.

Moreover, even when such structural changes have occurred, the development process has often failed to be inclusive, leaving too many people unable to find a decent job in the newly developed sectors or to grow their own business in an increasingly competitive and sophisticated economic environment. Besides, governments have often overlooked the environmental consequences of their choices in terms of sectors and activities on which to focus their development strategies. Depletion of natural resources, pollution, excessive urbanization and abandonment of rural areas and valuable traditional productions have often been the unintended long-term consequences of unsustainable growth and development policies.

The Sustainable Development Goals (SDGs) recently adopted by the international community – in particular SDG8 and SDG9 – include the goals of achieving inclusive and sustainable industrial diversification, higher productivity, technological upgrading and innovation. Governments are encouraged to adopt policies to promote the diversification of productive activities towards higher value added products and services, at the same time targeting decent job creation, entrepreneurship, creativity and innovation, and supporting the development of small enterprises.

The achievement of such goals entails massive public and private investments in education and training, infrastructure, technology upgrading and innovation, as well as in novel productive activities with higher value added content. Public investment has a fundamental role to play in this context. However, it cannot achieve alone the transformation of the industrial production structure. Private-sector investment is also an essential factor for at least two reasons. First, it provides a large amount of financial resources that can be used for the development process, alleviating the burden on public finances. Second, it provides the expertise and the efficiency orientation that often lacks in public enterprises. At the same time, private investors normally do not include development, inclusiveness and sustainability in their evaluations of investments profitability. It is therefore crucial for governments to offer the right incentives to attract private-sector investments into sectors with desirable spillovers in terms of diversification, employment creation, knowledge and technical capabilities accumulation, technology upgrading, environment protection or any other positive effects for the domestic economy.

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<sup>1</sup> This work would not have been possible without the advice and support of David Kucera, Senior Economist at the Development and Investment Branch of the ILO. I would like to thank also my father Riccardo Galli, Board Member of the University of Milan, and Ajit Ghose, Honorary Professor at the Institute of Human Development in New Delhi, for their valuable advice and enlightening conversations.

This research is structured around two chapters. The first chapter contains an overview of the literature on structural transformation and economic development, and in particular of the notion of economic development as a knowledge-based structural transformation process (section 1.1). Section 1.2 discusses how the Sustainable Development Goals (SDGs) include in the very notion of development the change in the structure of production and employment of developing countries towards products and services with higher value added and knowledge content, and call for government policies to promote these structural changes in an inclusive and sustainable way. Section 1.3 explains that structural transformation requires a *mix* of policies of different nature, coordinated and steered towards the common goals of accumulating domestic capabilities and inclusive development.

The second chapter focuses on public policies to mobilize *private* foreign and domestic investments, in particular through fiscal and financial incentives, to promote structural transformation and inclusive development. The analysis is based on a survey of fiscal incentives legislations across Sub-Saharan, South-Asian and South-East Asian developing countries and on country-specific cases of financial incentives in the same regions. This survey has led to the individuation of incentives used by developing countries to promote the diversification of national production, the accumulation of national productive capabilities and structural transformation more generally. In particular, we have classified the incentives associated with structural transformation into the following categories according to their specific goals: incentives for investments in high-value added sectors; incentives for the development of local supply chains; incentives for the promotion of quality-certified production; incentives for the development of small domestic enterprises. Moreover, we have included in a separate category the evidence on incentive regulations with explicit employment generation goals. A comparative analysis of these incentive regulations leads to finding the expected beneficial outcomes and the possible drawbacks of the incentives examined in relation to different policy objectives, on different agents and at different stages of development, as well as to finding possible improvements of the regulations and supportive policies.

The structure of the second chapter is as follows. Section 2.1 presents the different financial resources developing countries can draw from in order to finance their structural transformation and development goals, namely public domestic investment, private foreign and domestic investments, and public and private donations. Section 2.2 presents different kinds of fiscal and financial incentives, as well as an overview of the major issues regarding the use of incentives in general and as sectoral policy tools for structural transformation. The rest of the chapter contains a survey of the investment incentives currently used by developing countries in Sub-Saharan Africa, South-Asia and South-East Asia in five specific areas associated with structural transformation and job creation. Section 2.3 analyses incentives aimed at encouraging domestic and foreign private investments towards products and services with higher value added. Section 2.4 discusses incentives for the development of local supply chains and domestic production capabilities. Section 2.5 presents incentives for the promotion of quality-certified production. Section 2.6 focuses on incentives for the development of domestic small enterprises, and section 2.7 focuses on investment incentives aiming directly at employment generation. The last section provides conclusions and policy implications.



# 1. Structural Transformation and Development: Two Sides of the Same Coin

## 1.1 Literature overview on structural transformation and economic development

A large number of economists have long recognized that structural changes – defined as long-term and persistent changes in the sectoral composition of economic aggregates, in particular aggregate output or employment – are an essential ingredient of long-term sustained economic growth and economic development. Simon Kuznets in his Nobel Prize Lecture (1971) listed among the six main features of modern economic growth – besides the high growth rates of per capita product and of productivity – a high rate of structural transformation, defined broadly to include the shift away from agriculture to non-agricultural pursuits and, later, away from industry to services, as well as the change in the scale of productive units, and the related shift from personal enterprise to impersonal organization of economic firms, with a corresponding change in the occupational status of labor (*ibid.*, p.1). Interestingly, Kuznets also included in the list of the six main features of modern economic growth, next to the economic structural transformation, the rapid change in the “structures of society and its ideology” represented significantly by the urbanization and secularization processes.<sup>2</sup>

The importance of structural changes in economic development has been emphasized by different schools of economic thought. The Latin American structuralist economic thinking developed in the 1950s and 1960s at the United Nations Economic Commission for Latin America and the Caribbean (ECLAC) under the intellectual leadership of Raúl Prebisch emphasized the link between long-term growth and the transformation of production structures, with industrialization playing a crucial role in this transformation. More specifically, this stream of economic thought sees industrialization as a mechanism for the transmission of technological progress, both because of the associated investment in machinery and R&D, and because of production linkages and dynamic economies of scale generated by the learning processes associated with industrialization.<sup>3</sup> This view is expressed for instance by José Antonio Ocampo, Codrina Rada and Lance Taylor (2009), who state that “development requires economic transformation or the ability of an economy to constantly generate new dynamic activities, particularly those characterized by higher productivity and increasing returns to scale of production” (*ibid.*, p. 9).

Similarly many Post-Keynesian economists, mainly working in the Kaldorian tradition, have highlighted both at the theoretical and the empirical level the importance of a rising industrial sector –in particular manufacturing – in driving technological progress and long-term economic growth.<sup>4</sup> In parallel, other streams of economic literature – in part represented by the Evolutionary and Schumpeterian economic thinking – have focused on the relationship between structural changes and economic

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<sup>2</sup> The last two characteristics of modern economic growth listed by Kuznets relate to international aspects. One is the propensity of the economically developed countries to reach out the rest of the world, by means of the increased power of technology, particularly in transport and communication. Last, is the fact that the economic performance in countries accounting for three-quarters of world population still fell far short of the minimum levels feasible with the potential of “modern” technology.

<sup>3</sup> For an exhaustive discussion of the Latin American structuralist economic thinking see Ocampo (2014).

<sup>4</sup> A complete and updated review of this literature is found in Lavopa (2015).

development without a specific emphasis on the industrial sector, but stressing more generally the importance of building national capabilities to produce, imitate and innovate in any sector, from agriculture to services.<sup>5</sup>

At the same time, agricultural economists have argued that agriculture, like manufacturing, can be a primary source of long-run economic growth and structural transformation. As described in Diao *et al.* (2007), investments aimed at rising farm productivity in turn activate economic activities in other farm and non-farm sectors through demand linkages both for production and consumption goods and services.<sup>6</sup> More specifically, agriculture production linkages flow backward (farmers' demand for farm equipment, pumps, fuel, fertilizer and repair services) and forward (to non-farm processors of agricultural raw materials, transporters and distributors). Agriculture consumption linkages flow from increased farmers' incomes to higher consumer demand for non-agricultural goods and services as well as high-value farm commodities such as milk, meat and vegetables (*ibid.* p. 3).<sup>7</sup> Interestingly, Diao *et al.* point out that agriculture-based growth strategies, however, cannot neglect investments in non-agricultural sectors, in that these sectors have to grow in order to match the growing supply of agricultural products and the increasing demand for non-agricultural products. Otherwise, falling relative prices of agricultural products may dampen the realized gains in growth and poverty reduction (*ibid.* p. 29).

In an analogous way, several economists have focused in recent years on the possibility to base long-run growth and structural transformation strategies on advanced services, often based on ICT technologies. The main idea is that advanced services can play a leading role like manufacturing in that they are also tradable, characterized by economies of scale and generate positive macro spillovers. The literature on services-led growth is wide and evolves around contrasting views on the relationship between manufacturing and services. As explained in Kucera and Roncolato (2016), services are seen by various authors alternatively as a potential *substitute* for manufacturing (enabling countries to leapfrog industrialization), a *lagging complement* to manufacturing (i.e. demand for advanced services generated by manufacturing activities), or a *leading complement* to manufacturing (i.e. demand for manufacturing activities generated by advanced services). While the empirical debate about the relative importance of manufacturing and services as *separate* engines of economic growth is still open, some of the most interesting contributions point at the co-evolutionary dynamics of manufacturing and services, by which services can act both as leading and lagging complements to manufacturing (Guerrieri and Meliciani (2005), Andreoni and Gomez (2012), and Kucera and Roncolato (2016)).

Whatever the sector playing the primary role as source of long run growth and economic development, to the aim of the present work all these streams of economic thought provide intellectual support to two basic concepts. The first is that economic development is inherently a process of structural transformation, entailing a slow but irreversible change in the structure of economic aggregates, mainly aggregate production and employment, towards activities with higher knowledge and technology content. The

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<sup>5</sup> See Fagerberg *et al.* (2010) for a review of this literature.

<sup>6</sup> A seminal work by Hirschman (1958) disregarded agriculture as a primary source of growth for its supposedly weak linkages with the rest of the economy. See Diao *et al.* (2007) for a discussion of the literature contrasting Hirschman's view.

<sup>7</sup> Diao *et al.* report that estimated agriculture consumption linkages are more important than agriculture production linkages in Africa and Asia developing countries (*ibid.* p. 3).

second basic concept underlying this work is that in order for this process of structural transformation to take place, it must be accompanied by a process of accumulation of knowledge and capabilities. In short, economic development can be defined in terms of a knowledge-based structural transformation process.

A prominent example in support of this idea is provided by the economist Alice Amsden, who defines in her book *The Rise of the Rest* (2001) economic development as follows:

*“Economic development is a process of moving from a set of assets based on primary products, exploited by unskilled labor, to a set of assets based on knowledge, exploited by skilled labor.” (ibid, p. 2).*

A “knowledge-based asset” is defined by Amsden as a set of skills both managerial and technological, that can be science-based or artisanal, embodied in an individual or in a firm, depending on the scale of the physical plant and the complexity of the production process. According to Amsden, there are three types of technological capabilities: production capabilities (the skills necessary to transform inputs into outputs); project execution capabilities (the skills necessary to invest and expand capacity); and innovation capabilities (the skills necessary to design entirely new products and processes).

A similar view is expressed by Dani Rodrik (2006) who argues that economic development requires diversification (as opposed to specialization) and that diversification, in turn, is a learning process: “... enhancing an economy’s productive capabilities over an increasing range of manufactured goods is an integral part of economic development. The first order of business in development is *to learn how to do new things*, not to focus on what one already does well” (ibid, p. 5, emphasis added).

The centrality of learning in the development process is also the focus of Joseph Stiglitz and Bruce Greenwald’s recent book *Creating a Learning Society* (2014), in which the authors state:

*“Not only is the pace of learning (innovation) the most important determinant of increases in standards of living, the pace itself is almost surely partially, if not largely, endogenous. The speed of progress has differed markedly both over time and across countries, and while we may not be able to explain all of this variation, it is clear that government policies have played a role” (ibid., p. 15).*

In the context of South Asian countries, Ohno (2010) describes the development process as the gradual internalization of skills and knowledge initially borrowed from foreign investors. According to Ohno, the first stage of development takes off with the arrival of a sufficient mass of manufacturing FDI firms that perform simple assembly or processing of light industry products for export. In this early stage of development the country contributes only unskilled labor and industrial land, while key materials and parts are imported, and design, technology, production and marketing are all foreign-managed (ibid. p. 5)<sup>8</sup>.

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<sup>8</sup> According to Ohno, in Asia Indonesia, Philippines and Vietnam are at this stage.

The critical point to get to the next stage of structural transformation is – according to Ohno – the development of domestic supply of parts and components for the foreign-invested assembly firms. This is realized partly by the inflow of FDI suppliers and partly by the emergence of local suppliers. As this occurs, assembly firms become more competitive and a virtuous circle between assemblers and suppliers sets in. At this stage internal value creation rises moderately, but production still remains essentially under foreign management and guidance (*ibid.* p. 5).<sup>9</sup>

In the next stage – continues Ohno – countries face the challenge of decreasing their foreign dependence in all areas of production including management, technology, design or quality control. When this is achieved, the country emerges as a dynamic exporter of high-quality manufactured products (*ibid.* p. 6).<sup>10</sup> The structural transformation process culminates in the final stage when countries acquire the full capability to innovate and become global market leaders, such as the United States or Japan.

Note that Ohno describes the pattern of development of South Asian countries as a sequence of *successive* phases, along which countries rely decreasingly on FDI and gradually acquire national capabilities in all areas of production and related activities. With a partly contrasting view, Amsden (*ibid.* p. 281) distinguishes as *alternative* development strategies between the “independents”, less reliant on FDI and focused on developing national firms and capabilities and “make-technology” decisions, and the “integrationists”, more reliant on FDI and associated spillovers and focused on “buy-technology” decisions – with the former group embracing developing countries in Asia (China, India, Korea and Taiwan) and the latter group embracing Argentina, Brazil, Chile, Mexico and Turkey.

If economic history suggests that the transformation of the structure of production and the accumulation of knowledge and capabilities are the two key ingredients of successful economic development, it also shows that these processes do not happen automatically but need to be facilitated by the government through appropriate policies. Classic examples of successful economic development where the state has played a crucial role range from the United States and Great Britain to Japan, China and the East Asian Tigers.

In the context of current globalization and trade liberalization processes, the need of government policies in support of structural transformation and accumulation of national capabilities is even greater. It is not uncommon, in fact, for today’s latecomers of economic development to face a dilemma between pursuing short-term objectives of higher aggregate economic growth to please financial markets – often through government policies in favor of mining sector and promotion of unqualified FDI – or pursuing long-term objectives of knowledge accumulation, structural transformation and sustainable job-rich growth.

Taylor (2009) discusses the need for government industrial and development policies, and argues that “the objective should always be the promotion of patterns of structural change that lead to the accumulation of technological capabilities” (*ibid.*, p.12).<sup>11</sup> In the context of today’s export-oriented developing countries, Taylor proposes

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<sup>9</sup> According to Ohno, Thailand and Malaysia have reached this stage.

<sup>10</sup> According to Ohno, Korea and Taiwan are at this stage.

<sup>11</sup> Note that Taylor puts emphasis on the fact that the patterns of transformation will not necessarily be the same everywhere, in that they depend on a number of structural factors including the level of development

that: “policies should promote *innovative activities that generate positive domestic spillover*” (*ibid*, p.12, emphasis in text).

On this concept, Taylor makes three clarifications. First, “innovative” should be understood in broad sense as anything “new” for the country or region, from new technology to new markets and new products, irrespective of whether this activity is fully developed elsewhere. In this sense, export diversification in either products or markets are included as major policy goals.

Second, the generation of “positive domestic spillovers” is critical to justify state intervention. Governments should promote activities whose benefits go beyond the firm that undertakes the innovative activity. So “promoting pure assembly manufacturing or tourism with limited domestic contents is not desirable per se, unless that opens the space for further innovations down the line” (*ibid*, p. 13). Similarly the promotion of free trade zones and the attraction of foreign direct investment through tax breaks or full tax exemptions are not desirable policies, as they are “activities that tend to reduce, rather than increase domestic linkages and value added while at the same time creating low income, dead-end jobs” (*ibid*, p. 13).

Third, Taylor uses the term “activities” rather than “sectors” to attract the attention on the fact that the “accumulation of technological capabilities” (i.e. the overarching objective of industrial policies) does not necessarily occur only through the development of increasingly technologically sophisticated industrial sectors. Similarly, sectors other than manufacturing offer opportunity for innovation. According to Taylor, “these include modern services, but also primary production, both in niches high value-added products (e.g. fresh fruits and vegetables) and also the technological upgrading of other natural resource-intensive activities”.

Note that Taylor puts emphasis on the fact that the patterns of transformation will not necessarily be the same everywhere, in that they depend on a number of structural factors including the level of development already achieved, the accumulated technological capabilities, the natural resource endowments and the size of the economy. Successful policies must therefore be designed according to each country’s conditions and constraints.

Similarly Rodrik has argued in various papers that the process of structural economic transformation – central to sustained economic growth and development – needs the backing of government policies (Rodrik, 2004, 2006, 2010). Rodrik’s central argument lays not so much on whether or what policies should be implemented to favor the economic restructuring towards more dynamic activities, rather on *the process* through which these policies for economic restructuring should be designed and implemented. According to Rodrik, the key point is to avoid government’s *ex-ante* decisions about sectors or policy instruments and to allow a process of collaboration between the state and the private sector to arrive at the diagnosis about the sources of blockage in new economic activities and propose solutions to them. Finally note that Rodrik, like Taylor, includes non-traditional activities in agriculture or services as examples of “more dynamic activities”.

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already achieved, the accumulated technological capabilities, the natural resource endowments and the size of the economy. Successful policies must therefore be designed according to each country’s conditions and constraints.

## 1.2 Structural Transformation and the Sustainable Development Goals

As mentioned in the introduction, the Sustainable Development Goals (SDGs) include the idea that the process of economic diversification, structural transformation, technological progress and innovation are all embedded in the process of economic development.

In particular, under SDG 8 – namely “Promoting sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all” – target 8.2 calls for “Achieving higher levels of economic productivity through *diversification, technological upgrading and innovation*, including through a focus on *high-value added and labour-intensive sectors*” (emphasis added). In addition, SDG 9 – namely “Build resilient infrastructure, promote *inclusive and sustainable industrialization*, and foster innovation” – refers explicitly to industrialization and contains in target 9.2 the goal of significantly raising the industry’s share of employment and gross domestic product in developing countries.<sup>12</sup>

Moreover, two SDG targets encourage the use of government policies to support the structural transformation process in developing countries. These are target 8.3 – calling for “Promoting *development-oriented policies that support productive activities*, decent job creation, entrepreneurship, creativity and innovation, and encourage the formalization and growth of micro-, small- and medium-sized enterprises, including through access to financial services” – and target 9.b – calling for “Supporting *domestic technology development*, research and innovation in developing countries, including by ensuring a conducive policy environment for, inter alia, *industrial diversification and value addition to commodities*”.

It seems clear that the processes of diversification of production, value addition to commodities, technological upgrading and innovation have been officially recognized as a central part of the process of development, and that development-oriented policies supporting these processes are accepted by the international consensus. This gives a much higher legitimacy to government policies in support of productive activities and domestic technology development provided that these policies are not abusively protectionist and that they incorporate inclusiveness and sustainability objectives.

Moreover, in the SDGs it is acknowledged that industrialization and structural transformation must be inclusive processes. For this to happen decent jobs must be created and the development efforts must be focused on high value-added *and* on labor-intensive sectors, as well as on micro, small and medium enterprises. This is important, since in many developing countries the efforts to create economic growth and structural transformation have failed to produce inclusiveness and human development.

In some cases, this was the result of policies focused exclusively on obtaining high rates of aggregate growth through capital-intensive sectors like mining, without devoting attention on how to use the income generated by the mining sector to sustain the development of other more labor-intensive sectors and human development more generally. In other cases, the efforts to industrialize were excessively concentrated on

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<sup>12</sup> Target 9.2 calls for “Promoting inclusive and sustainable industrialization and, by 2030, significantly raise industry’s share of employment and gross domestic product, in line with national circumstances, and double its share in least developed countries”.

large urban centers, generating an over-proportional rural-urban migration and resulting in a mass of urban dwellers unable to find a decent job and living at the margin of huge urban agglomerates. Last, but not least, industrialization and structural transformation policies have sometimes overlooked the needs of self-employment activities and micro-businesses, where employment is mostly concentrated in developing countries.

In this sense, in our opinion the focus on industrialization contained in SDG 9 should be interpreted in a more general sense of promoting the diversification of production and employment towards products and services with higher value added and knowledge content, be they in agriculture, industry or services. Although the experiences of North America, Europe, Japan and more recently the South East Asian countries show that industrialization can lead to sustained economic growth, we think that agriculture-led growth and service-led growth (including tourism-led growth) are also possible paths to structural transformation and sustainable and inclusive economic development. Moreover, these structural transformation paths – industrial, agriculture-based and service-based – are not necessarily alternative, but can be pursued in parallel with different spatial and temporal paces.

In particular, given the negative consequences of industrialization in terms of excessive urbanization and environmental damages, low-income countries that have yet to undergo the process of structural transformation, may complement industrialization strategies with structural transformation strategies based on sustainable agriculture, organic farming, agro-allied industries, artisanal activities, recycling and rural development more generally. Similarly, developing countries with natural and cultural endowments can base their structural transformation process on developing high value-added services like sustainable tourism, cultural activities and related hospitality, transport, and entertainment services.<sup>13</sup>

More generally, in this report the process of economic structural transformation from a primary resources-based economy to a more advanced industrial-based, agro-industrial-based, or advanced services-based economy, is seen as a *mean* (not a goal in itself) to reach higher levels of economic and *human* development. In this sense, this work is fundamentally based on Amartya Sen's idea of economic development as expressed in his book *Development as Freedom* (1999). In the first page of the book, Sen defines development as the “process of expanding the real freedoms that people enjoy”, and states that:

“Focusing on human freedoms contrasts with narrower views of development, such as identifying development with the growth of gross national product, or with the rise in personal incomes, or with *industrialization*, or with *technological advance*, or with social modernization” (*ibid*, p. 1, emphasis added)

All these factors – income growth, industrialization, technical progress and social modernization – are seen by Sen as means to expanding the freedoms enjoyed by the members of the society, i.e. means towards and not goals of economic development. The mirror image of development as the process of expanding freedoms is Sen's idea that development requires the removal of major sources of “unfreedom”. Among these, Sen listed economic poverty – which denies people the freedom to access basic needs like

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<sup>13</sup> See the African Transformation Report 2014, by the African Centre for Economic Transformation, discussing the possible paths of structural transformation: “Leveraging abundant labor for manufacturing”, “Kick-starting agro-processing value chains”, “Managing oil, gas and minerals”, and “Boosting tourism”.

food, shelter, healthcare and sanitation – but also the lack of public healthcare, education and social care, as well as the denial or restriction of political and civil liberties.

Accordingly, the present report is grounded on the underlying consideration that structural transformation policies should be coordinated with policies aiming at expanding the freedoms enjoyed by the members of a society, through better health, higher education and employability, extended access to technology and infrastructures, fair political institutions and stronger civic participation.

### 1.3 The Structural Transformation Policy Mix

As discussed in the previous sections, there is an international consensus – expressed by the SDGs – about the importance of structural transformation in the development process and about the fact that governments can and should adopt policies to facilitate these processes. We shall call these policies Structural Transformation Policies (STPs).

The structural transformation of production and employment aggregates towards higher value-added products and higher productivity jobs is a long-term process that entails developing a country's set of knowledge assets and capabilities towards gradually higher levels of complexity. Policies aiming at facilitating these complex learning processes, then, cannot be one-sided but have to be manifold, ranging across different policy fields.

Figure 1 illustrates this concept by showing that STPs entail a *mix* of different types of policies, ranging from investment policy, to education & training policy, technology & innovation policy, employment policy, rural and urban policy, and trade policy.<sup>14</sup>

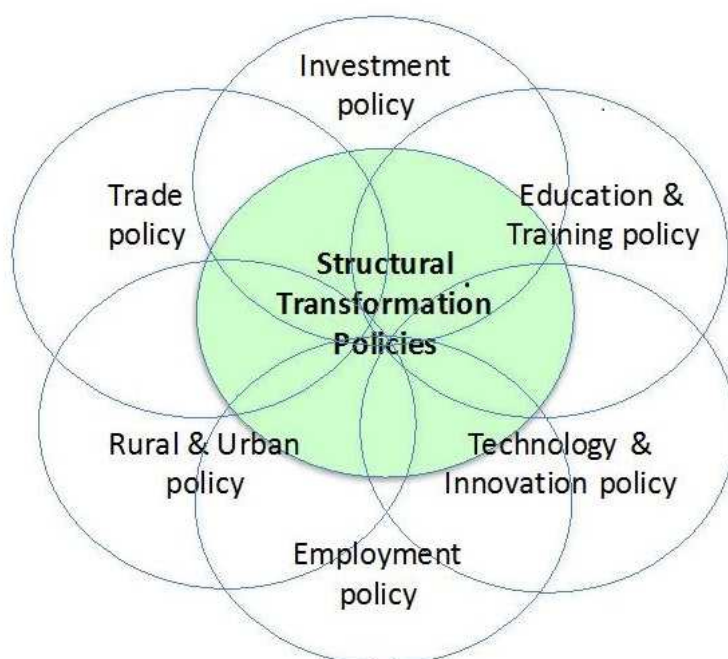
More specifically, Figure 1 illustrates two basic ideas. The first is that a country's structural transformation cannot be achieved by using only (or predominantly) one type of policy. For instance, there is ample evidence that a country's human capital – in particular the availability of technical knowledge – acts as a key trigger or bottleneck for economic growth and development. Often the shortage of skilled labour, technicians, analysts, engineers, and scientists (but also experts in humanities and local environment, arts and cultures) prevents the efforts made to attract new investments in higher value-added sectors to generate the desired spillovers in terms of local employment, development of domestic firms, and the gradual creation of fully domestic value chains. Therefore, investment policies alone cannot achieve a country's effective structural transformation. Education and training policies aiming at the accumulation of the appropriate human capital and skills necessary for the country's structural transformation are a key component in the Structural Transformation Policy mix.

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<sup>14</sup> In this context, industrial and sectoral policies can be seen as falling in the field of investment policy. Also note that the above list of policies related to structural transformation is not exhaustive, and has to be interpreted as an indication of policies playing an important role in structural transformation strategies.



Figure 1. Structural Transformation Policies



Source: Authors's own elaboration

The second basic idea illustrated by Figure 1 is that these policies can – and not necessarily do – aim at the country's structural transformation, i.e. the accumulation of knowledge and production capabilities.

Let's take for instance investment policy. Investment policy tools such as the promotion of free trade zones and the attraction of foreign direct investment through tax breaks or full tax exemptions – designed without incentives for generating knowledge spillovers on domestic firms and local workforce are not part of the policy set for structural transformation. On the other side, incentives designed for attracting foreign and domestic investment in activities involving knowledge transfer to local producers can be effective investment policy tools for the economic diversification and the accumulation of technological and productive capabilities of the country.

In an analogous way, traditional rural policies to subsidize farming do not necessarily help the emergence of new dynamic activities in the primary sector. On the other side, policy measures to support the introduction and diffusion of knowledge and new technologies among farmers are an example of rural policies aimed at structural transformation.

Similarly, with regards to technology & innovation policies, policy measures to promote public and private investments in R&D are necessary but not sufficient conditions to develop the country's innovation capabilities. Experts in the field have long recognized in fact that the innovative performance of countries cannot be explained simply by the relationship between inputs (such R&D expenditure) and outputs (such as patents), and that the interactions among the three main agents involved in technology development – enterprises, universities/public research organizations and government – are as important as investments in research and development (OECD, 1997). In that sense, policies aimed at facilitating the *flow* of knowledge among these three agents are needed for the development of innovation capabilities. For instance, including in the evaluation of universities the assessment of their ability to collaborate with industry is an example of a policy measure aimed at increasing industry-academia collaboration and

therefore supporting the development of a country's innovation capabilities and structural transformation (UNCTAD, 2015a, p. 91).

In sum, this section would like to acknowledge and clarify that structural transformation cannot be reached through one *single* policy – be it investment policy, trade policy, employment policy or any other policy – but only through a *mix* of policies. All these policies, in turn, must be steered towards the common goals of accumulation of knowledge and domestic production capabilities and inclusiveness, as without a coordination and mutual reinforcement each of these policy pillars are less likely to succeed in their mission of promoting structural transformation and inclusive economic development.

## 2. Making Investment Incentives Work for Structural Transformation and Inclusive Development

### 2.1 Financing structural transformation and sustainable development goals

The transformation of an economy from a simple rural economy into a more diversified and technologically advanced one requires extensive public and private investments in new economic activities as well as in infrastructure, education and training, technology upgrading and R&D in order to support the creation and expansion of the domestic production of goods and services with higher value added and technological content.

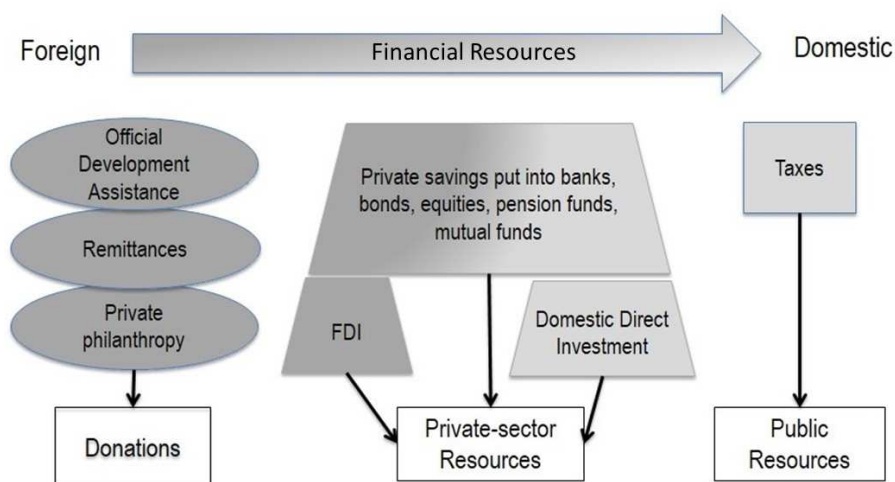
A crucial question is therefore where from can developing countries draw the financial resources needed to finance their structural transformation and development? As discussed in the UN Third International Conference on Financing for Development held in Addis Ababa in July 2015, there are essentially three possibilities (depicted in Figure 2): domestic public resources, domestic and international private resources, and (mainly international) public and private donations (UN, 2015).

As shown in Figure 2, a first source for financing development is represented by public and private donations, comprising Official Development Assistance (ODA), remittances and private philanthropy. With the exception of private philanthropy, which can be also of domestic origin, donations are essentially foreign financial resources. Note that while total ODA in 2014 measured 181 USD billion (in 2012 constant prices), remittances from migrants in the same year measured 351.5 USD billion (in 2012 constant prices), almost two times higher than ODA.<sup>15</sup> As for private philanthropy, it amounts to 60-70\$ billion a year equivalent to about half of ODA disbursed annually (World Bank, 2013, p.19). All three types of donations are therefore substantial and indeed constitute a very important financial source for developing countries, in particular low-income countries.

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<sup>15</sup> OECD data retrieved from [https://public.tableau.com/views/Non-ODAflows/ResourceReceipts?%3Aembed=y&%3Adisplay\\_count=no%3F&%3AshowVizHome=no#1](https://public.tableau.com/views/Non-ODAflows/ResourceReceipts?%3Aembed=y&%3Adisplay_count=no%3F&%3AshowVizHome=no#1) on June, 21 2016.

**Figure 2. Financial Resources for Development**



Source: Author's own elaboration

Without diminishing the value of donations and the need for nurturing them, however, an exclusively aid-based development strategy is neither realistic nor the most effective option for developing countries. There is a wide empirical literature on the effects of foreign aid on economic growth in developing countries. The empirical findings are mixed, suggesting that aid and growth are neither positively, nor negatively related (see for instance Ekanayake and Chatrna, 2010). Moreover, it has been argued that foreign aid tends to slow down institutional learning-by-doing, increasing the risk of aid-dependency (Azam *et al.* 1999). Relying increasingly on domestic resources instead could allow developing countries to accumulate domestic governance capacities, strengthening their political accountability and making them more independent from ODA volatility (Byiers and Dalleau, 2011).

As argued by Roy *et al.* (2009): “If the idea that it is neither expected nor desirable for foreign aid to completely cover the shortfall in resources necessary for achieving these goals (i.e. the MDGs) is taken seriously, then it is necessary to undertake an exhaustive examination of the possibilities that states have for reorienting internal resources towards the objectives of poverty reduction. The search for these sources is, in a nutshell, what is called the search for ‘fiscal space’ ” (*ibid*, p. 3).

Mobilizing resources other than foreign aid becomes therefore the key to finance structural transformation and inclusive development in developing countries. As shown in Figure 2, non-aid financial flows can be mobilized essentially from two sources: domestic and international private-sector financial resources, and domestic public resources, which are mainly constituted by taxes. The latter option is what in the literature is known as Domestic Resource Mobilization (DRM). Since low-income and middle-income countries have an average tax to GDP ratio between 10% and 20% while in high-income OECD countries it is in the range of 30-40%, increasing tax collection is a possible way for developing countries to finance their development objectives (European Parliament, 2014, p.10).

Note that government revenues can be increased without necessarily imposing new taxes or higher tax rates. In fact, by upgrading tax collection capacity and making tax declaration and payment processes simpler (through tax reforms, digitalization, improved audits and enhanced taxpayer services), as well as by broadening the tax base,

developing countries can increase their tax revenues as a percentage of GDP without increasing their tax rates.<sup>16</sup>

As shown in Figure 2, besides nurturing donations and raising more domestic public financial resources through improved tax collection, developing countries have a third option to finance their development process: mobilizing domestic and international private-sector financial resources – formed by private savings put in bank accounts, bonds, equities, mutual funds, pension funds, or invested directly into national companies – and channeling them into development-compatible investment projects.

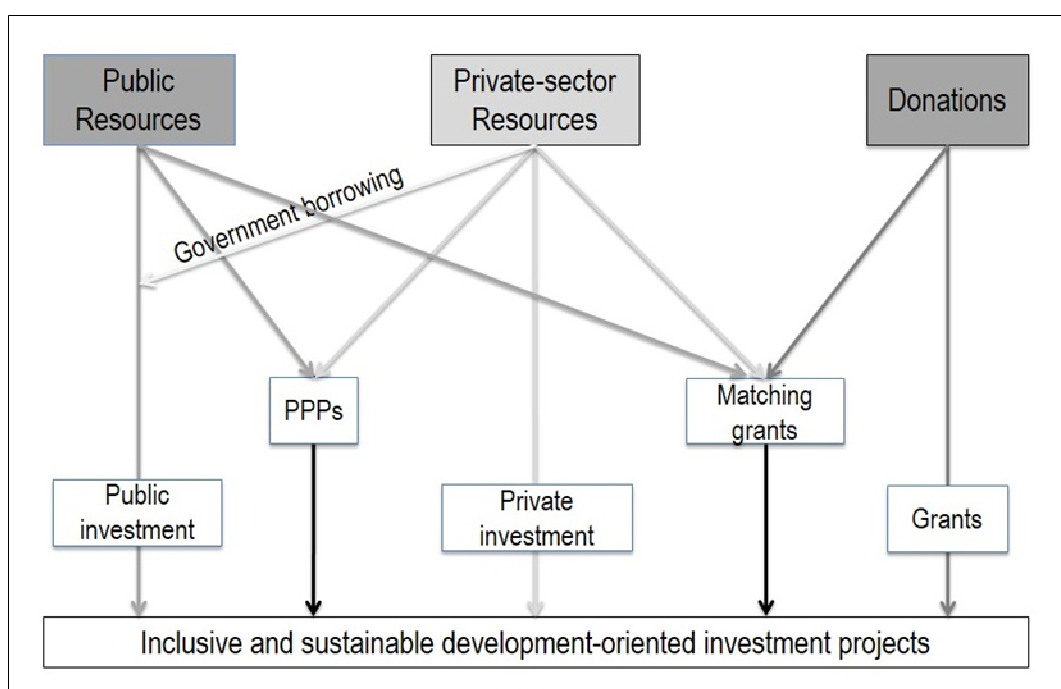
The idea that private-sector investment is a primary driver of economic development is a core principle of UNCTAD’s *Investment Policy Framework for Sustainable Development* – officially launched at the Third International Conference on Financing for Development held in Addis Ababa in July 2015 (UNCTAD, 2015b). The Framework argues that developing countries’ investment policies should be integrated with their development strategies, and that in order to facilitate this process developing countries’ Investment Promotion Agencies should evolve into investment development agencies (*ibid.* p. 122). Moreover, UNCTAD suggests that “new generation” investment policies should place inclusiveness and sustainability on the same footing as economic growth in their objectives. To this aim, UNCTAD encourages policymakers to focus on “qualitative aspects of investment” by targeting investment in areas key for economic or industrial development and for the build-up, maintenance and improvement of productive capacity and international competitiveness (*ibid.*, pp. 122-124).

Figure 3 shows how the three main types of financial resources can be channeled towards investment projects supporting a country’s economic, inclusive and sustainable development. In particular, it shows that different financial resources can be also combined in the same investment project, such as in public-private-partnerships (PPPs), in ‘matching grants’ (partnerships between private donors and private or public investors), or in public investment projects financed by borrowing from the private sector.

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<sup>16</sup>See for instance El Salvador case study described by USAID at [https://www.usaid.gov/sites/default/files/documents/1865/E1%20Salvador%20Tax%20Reform%20Case%20Study\\_fall%202014.pdf](https://www.usaid.gov/sites/default/files/documents/1865/E1%20Salvador%20Tax%20Reform%20Case%20Study_fall%202014.pdf).

**Figure 3. Financing Structural Change and Development**



Source: Author's own elaboration

In sum, the above discussion suggests that development strategies focusing only (or mainly) on one type of financial resources are self-limited. If focusing almost exclusively on foreign aid or on foreign direct investment has often proved a short-sighted development strategy, also focusing almost exclusively on public investment can be an inefficient choice for developing countries. A better option is probably to maximize the flow of public *and* private financial resources of all kinds, and to channel them into development-compatible investment projects, including through mixed public-private financial tools such as PPPs or matching grants.

The remainder of this chapter restricts the analysis to just one of the above-mentioned possible strategies for financing development, i.e. the use of incentives for the mobilization of private-sector investments in areas key for a country's structural transformation, build-up of domestic knowledge and productive capacity, and inclusive development.

More specifically, section 2.2 presents different kinds of fiscal and financial incentives, as well as an overview of the major issues regarding the use of incentives in general and as sectoral policy tools for structural transformation. The following sections contain a survey of the investment incentives currently used by developing countries in Sub-Saharan Africa, South-Asia and South-East Asia in five specific areas associated with structural transformation and job creation. In particular, we examine the state of the art, and the possible beneficial outcomes and drawbacks of: investment incentives aimed at promoting investments higher value-added sectors (section 2.3); investment incentives aimed at developing local supply chains (section 2.4); investment incentives aimed at promoting quality-certified production (section 2.5); investment incentives aimed at promoting SMEs development (section 2.6); and investment incentives with direct employment targets (section 2.7). The last section offers some conclusive remarks and policy implications.

## 2.2 Investment Incentives as Policy Tools for Structural Transformation

As discussed in the previous section, private-sector financial resources mobilization is one of the channels that developing countries can use to finance their development objectives (the others being public resources and foreign and domestic donations). This means finding ways to stimulate domestic and international private investors to direct funds into sectors and activities prioritized for the country's structural change and inclusive and sustainable development goals.

Since in the private sector investment decisions are driven by risk-adjusted return considerations, governments use investment incentives as policy tools to influence the decisions of investors by increasing the return or decreasing the risk (or both) of targeted investments, making them more attractive for the private sector. There are three main categories of investment incentives: *fiscal* incentives, such as tax reductions, exemptions and deductions; *financial* incentives, such as various grants and loans; and other incentives (sometimes named *non-fiscal* incentives), such as subsidized infrastructure or regulatory concessions.

Fiscal incentives can be classified in four main categories: profit or income-based, expenditure-based, import-based and export-based (see Table 1). Profit-based tax incentives are reductions of the standard Corporate Income Tax (CIT) rate or temporary exemptions from it (tax holidays) offered to companies investing in specific industrial sectors, geographical areas or satisfying specific requirements. They include also regulations concerning the allowance to carry forward losses for income tax purpose over the following fiscal years.

*Expenditure-based tax incentives* (also known as “investment allowances”) are deductions from taxable income (or tax credits) based on a percentage of qualifying expenditures incurred by eligible companies, resulting in a reduced tax base and hence in lower tax payments. Qualifying expenditures can be capital expenditures (such as new machineries), or other expenditures such as R&D, training and labor-related expenditures, or marketing and promotional activities. In some cases, qualifying expenditures can be fully deducted at 100%, or even over-deducted (a percentage higher than 100% of the expenditure can be deducted from taxable income), *de facto* providing a partial subsidy for the qualifying expenditure. Expenditure-based fiscal incentives include accelerated depreciation, which allows the beneficiary companies to apply enhanced depreciation rates in the first year(s) of use of specific new capital assets, so reducing the amount of tax payments due in the year(s) after the investment.<sup>17</sup>

Finally *import-based* tax incentives consist mainly of exemptions from import duties on machinery and equipment or parts and raw materials used as inputs for the production process; and *export-based* tax incentives include mainly exemptions from export duties and preferential tax treatment for income from exports.

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<sup>17</sup> Generally capital assets expenditures are allowed to be deducted from taxable income over a certain number of years according to asset-specific depreciation rates provided by the tax code.

**Table 1. Main categories of fiscal incentives**

Profit/income-based	Reduced CIT rates, tax holidays and tax discounts offered to companies investing in specific industrial sectors, geographical areas or satisfying specific requirements (such as firm size, value added created, number of new workers hired, etc.); loss carry forward allowance
Expenditure-based	Income-tax deductions based on capital expenditures (investment allowance) or on other specific expenditures (such as R & D, training, other labor-related expenditures, marketing and promotional activities, etc.); accelerated depreciation
Import-based	Exemptions from import duties on machinery, equipment or raw materials, parts and inputs related to the production process
Export-based	Exemptions from export duties; import duty drawback on imported inputs used for producing goods for export; preferential tax treatment for income from exports

Source: Author's re-elaboration of UNCTAD (2000, Table 3, p. 20)

Through *financial* incentives governments aim at supporting investors in gathering the financial assets needed to initiate prioritized investments. Financial incentives can take various forms, from providing favorable loans through government development agencies, to offering private investors embarking upon new projects capital grants or interest rates reimbursements on bank loans, and offering commercial banks incentives to expand their credit supply to targeted investors at contained interest rates (such as with loan guarantees and refinance schemes).<sup>18</sup>

All types of investment incentives – if appropriately designed – can act as investment catalysers, in the sense that by reducing the costs and mitigating the risks associated to the targeted investments, they can induce the private sector to participate to projects that it would have otherwise not financed.

Most developing countries use fiscal and financial incentives – in particular reductions of, or temporary exemptions from, the standard CIT rate – as sectoral policy tools for attracting investments (often called ‘pioneer’ investments) in strategic sectors or activities not yet well-developed in the country.<sup>19</sup> The beneficiaries of the incentives can be foreign and domestic producers of final goods and services not yet produced (or under-supplied) in the country, for export or sale in the domestic market (with the aim of adding *new* value chains to the structure of production) or foreign and domestic producers of intermediate goods and services supplied to large companies based in the

<sup>18</sup> More detailed definitions of loan guarantees and refinance schemes are provided in section 3.2 “Financial incentives to support SMEs access to credit”.

<sup>19</sup> Sector-specific CIT rates can be not only reduced but also enhanced in order to pursue diversification and development goals. This is the case for instance in six Sub-Saharan countries (Botswana, Ghana, Ivory Coast, Malawi, Namibia, and Zambia) and two Asian countries (Papua New Guinea and Vietnam), which have established for mining and extractive companies a CIT rate higher than the standard, reflecting the efforts of the governments to diversify away from mining. Note moreover that Ivory Coast has established an enhanced CIT rate also for telecommunication, information technology, and communication services, and Pakistan for the banking sector. In addition, some countries explicitly exclude some sectors from the possibility to enjoy tax holidays. For instance, the Democratic Republic of Congo’s Investment Code excludes from special fiscal regimes mining and hydrocarbon, banking and insurance, and trade, and Ivory Coast excludes residential construction, trade, and banking and finance services.



country (with the aim of deepening the backward and forward domestic integration of *existing* value chains).<sup>20</sup>

The list of beneficiary sectors in each country ranges from various manufacturing sub-sectors, to agriculture and agro-processing, tourism, energy, communications and infrastructure sectors, and can be as detailed as adding up to more than 70 prioritized activities (as in Nigeria).<sup>21</sup> As an example, Table 2 shows the economic production activities that are currently granted exemptions from paying income tax for a specified number of years from the beginning of operations in Ethiopia.

**Table 2. Ethiopia's sector-based income tax exemptions**

Areas of investment eligible for exemption of income tax	CIT exemption (years)	
	Addis Ababa and Special Zone of Oromia surrounding	Other Areas
<b>1. Manufacturing</b>		
Food industry	1-5 years	2-6 years
Beverage industry	1-3 years	2-4 years
Textiles and textiles products in industry	2-5 years	3-6 years
Leather and leather products industry (except tanning of hides and skins below)	2-5 years	3-6 years
Wood products industry	2 years	3 years
Paper and paper products industry	1-5 years	2-6 years
Chemical and chemical products industry	2-5 years	3-6 years
Basic pharmaceutical products and pharmaceutical preparations industry	4-5 years	5-6 years
Rubber and plastics products industry	1-4 years	2-5 years
Other non-metallic mineral products industry	1-4 years	2-5 years
Basic metal industry (excluding mining of minerals)	3-5 years	4-6 years
Fabricated metal products industry (excluding machinery and equipment)	1-3 years	2-4 years
Computer, electronic and optical products industry	2-4 years	3-5 years
Electrical products industry	2-4 years	4-5 years
Machinery and equipment industry	5 years	6 years
Vehicles, trailers, and semi-trailer industry	2-5 years	3-6 years
Manufacturing of office and household furniture (excluding those made of ceramic)	1-4 years	2-5 years
Manufacturing of other equipment (jewellers and related articles, musical instruments, sports equipment, games and toys and similar products)	1 years	2 years

<sup>20</sup> Note that sector-based tax reductions and exemptions therefore have different motivations from location-based tax incentives offered to companies settling in Export Processing Zones (EPZs) (with the policy goal of maximizing exports) or in specific geographic areas (with the policy goal of developing specific regions).

<sup>21</sup> Nigerian Investment Promotion Commission, <http://www.nipc.gov.ng/index.php/invest-in-nigeria/investment-incentives.html> retrieved in June 2016.

Areas of investment eligible for exemption of income tax	CIT exemption (years)	
	Addis Ababa and Special Zone of Oromia surrounding	Other Areas
Integrated manufacturing with agriculture	4 years	5 years
<b>2. Agriculture</b>		
Crop production (except growing of fibre crops, medium-term spices, aromatic or medicinal crops, perennial fruits, beverage crops and other perennial crops Addis Ababa and its surroundings)	2-3 years	3-6 years
Animal production (except farming of wild animals and production of milk, eggs and similar products in Addis Ababa and its surroundings)	2-3 years	3-4 years
Mixed (crop and animal) farming	3 years	4 years
Forestry	8 years	9 years
<b>3. ICT</b>	4 years	5 years
<b>4. Generation, transmission and supply of electrical energy</b>	4 years	5 years

Source: Ethiopian Investment Commission (<http://www.investethiopia.gov.et/images/pdf/incentives.pdf>)

Ideally, the choice of the beneficiary sectors should be supported by an input-output analysis of the production and consumption demand linkages generated backward and forward by the sector receiving the tax incentive.<sup>22</sup> In this way, a sector's overall potential to increase aggregate production and generate employment can be precisely estimated. In practice, however, input-output analyses are not very common, and often countries rely on different considerations to decide which sectors to prioritize in their investment policies.

A way through which governments try to select the investments with positive spillovers the domestic economy is by adopting – instead of (or besides) simple industry-based incentives – fiscal incentives *conditional* upon some indicators of the spillovers on the domestic economy, such as the local creation of value added or the development of local supply chains (as we shall see in the following sections).

Although very commonly used, investment incentives are controversial in that they represent a direct reduction in government tax revenues (fiscal incentives) or an increase in government expenditures (financial incentives) and offer possibility of rent-seeking actions (see for instance Action Aid, 2015a and 2015b). Hence, since investment incentives are both very common and controversial industrial policy tools, it is important to understand what characteristics they should have to maximize their positive impacts for the country (e.g. facilitating the building up of domestic production capacities and local value added creation, creating employment, increasing products quality, promoting inclusiveness, reducing environmental impact, and leading to development more generally) while minimizing their negative impacts on government revenues and expenditures or on the risk of waste and rent-seeking.

<sup>22</sup> As discussed in the first chapter (section 1), Diao et al. (2007) provide an example of this kind of analysis for the agricultural sector in Ethiopia.

Investment incentives have self-evidently the disadvantage of reducing government tax revenues or increasing government expenditures. From a strictly economic point of view their use is therefore justified if they imply a higher-than-proportional increase in future government revenues, so that the tax revenue foregone (or increased expenditure) in the short run is offset in the long run. This would be the case, for instance, of tax incentives for infrastructure projects, or tax concessions that generate new economic activities *and* new jobs, which in turn generate further income and employment opportunities leading to a multiplier-effect in GDP, employment and tax revenues. Moreover, some investment incentives – such as fiscal incentives for investments in R&D, green technology, basic health and education services, or cultural activities – contribute *per se* to enhancing public welfare, compensating for the revenue foregone. Since private investors generally do not include public welfare considerations in their evaluations of investments profitability, incentives help making public benefits become perceptible in investors' decisions. Once long-run considerations and the wider dimension of human and sustainable development are taken into account, then, a larger selection of investment incentives becomes justifiable.<sup>23</sup>

It should be noted however that the public revenue foregone could be collected and used to provide public services or to finance directly industrial, social or environmental development investment projects. The evaluation of the costs and benefits of fiscal incentives depends therefore also on the alternative ways public revenues would be spent on and on the relative efficiency of public and private investment projects. The challenge for policy-makers is to determine under what circumstances spending public funds (or giving up public revenues) on incentives is a worthwhile policy.<sup>24</sup>

If investment incentives can be a worthwhile policy, this is not to say that they do not create opportunities to grant privileges to vested interests. They unfortunately do, in many cases. However, corruption and rent-seeking are linked to the way the instruments are designed and applied rather than to the nature of the instruments themselves. As discussed by Dani Rodrik (2004) in his paper “Industrial Policy for the Twenty-First Century”, the right framework to maximize the potential contribution of government policies to economic growth and development while minimizing the risks of waste and rent-seeking, should be based on three principles. The first is “embeddedness”, i.e. a “strategic collaboration between the private sector (firms) and the government, with the aim of uncovering where the most significant obstacles to restructuring lie and what type of interventions is most likely to remove them” (Rodrik, 2004, p. 2). The second is “discipline”: “Firms and industries that receive help from the government must know that they cannot game the system, and that underperformance will result in the removal of assistance” (Rodrik, 2014, p. 485). This implies that “government incentives need to be temporary and based on performance” (Rodrik, 2010).<sup>25</sup> Last, but not least, in Rodrik's argument is the principle of “accountability”: “The operation of the deliberation/coordination councils should be published and the decisions reached

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<sup>23</sup> An interesting discussion in this respect is provided by Roy *et al.* (2009).

<sup>24</sup> Moreover, countries can be tempted to provide fiscal incentives in a sort of tax competition to attract FDI in the region, creating a ‘race to the bottom’ that leads to unproductive tax base erosion. In turn, the tax base erosion withdraws resources that could be used to improve the prime drivers of investment decisions such as education and infrastructure. This may create a vicious circle of lower tax rates, sluggish development outcomes and fewer investments in the country.

<sup>25</sup> Performance-based incentives require clarity of program objectives and *ex-ante* measurable targets. There are various possibilities to design temporary and performance-based government incentives, ranging from automatic sunset clauses (firms must demonstrate they met program targets to get renewal of support schemes), to formal independence and full accountability of industrial policy agencies (Rodrik, 2014).

announced. There should be full accounting of public resources spent in support of new activities” (Rodrik, 2004, p. 21).

Another factor influencing the effectiveness of investment incentives (in particular of CIT rates reductions and exemptions) to stimulate targeted investments is the fact that the tax burden is only one of the factors investors take into account when making the decision of setting up a new company. Several studies provide evidence that tax incentives are secondary factors in investors’ decisions after more fundamental determinants, such as market size, access to raw materials, availability of skilled labor and necessary infrastructures (UNCTAD, 2000). However, this is generally more relevant for foreign than for domestic investors, who are often bounded to the domestic market and do not necessarily make a prior screening of other countries’ business opportunities. In that sense, tax incentives can be more effective in stimulating *domestic* investment towards the targeted sectors or activities than in attracting FDI.

Moreover, in middle-income countries, where the process of formalization of small and medium enterprises (SMEs) is relatively advanced, tax incentives may play a more important role in the investment decisions of SMEs than of large firms. This is because SMEs lack the financial and human capacity to diversify investment in the international context and to develop sophisticated tax avoidance strategies (Nam and Radulescu, 2007). Given the importance of SMEs in the structure of employment of developing countries, tax incentives can therefore play an important role to address employment and inclusiveness objectives in the development policy strategies of middle-income relatively formalized developing countries.

Against this background, this study provides a survey of tax and investment legislations currently used by several Saharan African, South Asian and South East Asian developing countries and of country-specific cases of financial incentives in the same regions. Based on this survey, the paper individuates common and innovative practices, and investigates the potential beneficial outcomes and possible drawbacks of specific investment incentives regulations with respect to different structural transformation and inclusive development policy goals, on different agents and at different stages of development. In particular, we examine fiscal and financial incentives in relation to five policy goals related to structural transformation and inclusive development: domestic value added augmentation, local supply chains development, promotion of quality-certified production, SMEs development, and employment generation.

Through this analysis, we aim at providing guidance about the design of investment incentives with structural transformation and inclusive development goals, according to the specific policy objectives and level of development. A number of possible regulation improvements and supportive policies are suggested for each category of investment incentive and policy goal examined. We are aware of the fact that the final impact of any incentive regulation depends not only on its design but also on its implementation. However, on one side, we trust that an appropriate design increases the probability that the incentive regulation achieves the desired policy objectives. On the other side, given the wide number of developing countries covered in this analysis, the study of how investment incentives are *de facto* implemented in specific countries and what is their actual impact would go beyond the scope of this paper, and is left for further research.

The present study differs from similar previous studies in various respects. First, it does *not* focus on fiscal or financial incentives aimed *primarily* at attracting FDI *per se* and promoting the *volume* of exports, such as in Export Processing Zones. Rather, special attention is devoted to fiscal and financial measures aimed (primarily but not exclusively) at stimulating *domestic* investments, especially SMEs. For this reason, the

current paper differs from the literature focusing on the effectiveness of tax incentives to attract FDI (e.g. Klemm and Van Parys, 2009).

Moreover, few studies provide multi-country examinations of tax legislations on investment tax incentives (such as UNCTAD, 2000 or Reva, 2015), and even fewer emphasize the impact that incentives can have on stimulating domestic investment or creating jobs (as in James, 2013). The study by James (*ibid.*), in particular, suggests an interesting cost-benefit analysis for investment incentives, where the benefits are measured in terms of jobs created by those investors who changed their decision to invest as a result of the tax incentive.

Given our focus on the role of investment incentives can play to pursue industrial policy goals (such as diversifying production, increasing local value added, achieving certified quality production) as well as to pursue inclusive and sustainable development goals (such as creating jobs, and promoting and protecting the natural and cultural environment), our work is also close to the recent report by UNCTAD (2015) on “Investment Policy Framework for Sustainable Development”.

Finally, since structural transformation is a primary objective in the development strategies of low-income and lower-middle income countries, the present study focuses the analysis on world regions where low-income and lower-middle income countries are highly concentrated, i.e. sub-Saharan Africa, South-Asia and Southeast Asia. Within these world regions, we decided not to limit the number of countries to examine, but to keep the country-coverage open-ended, in order to maximize the variety of examples of development-oriented investment incentives in use. This implies that the countries represented in each table vary depending on whether and for which countries it was possible to find examples of the type of investment incentive specifically analyzed.

Moreover, since the information sources for fiscal investment incentives are essentially to be found in investment laws and investment promotion agencies, it was possible to conduct a fairly complete survey of fiscal incentives for a large number of countries. In contrast, the information on financial incentives are diffused across several different governmental agencies (central banks, national development banks, industry ministries, etc.) so that a systematic cross-country analysis for financial investment incentives in such a large number of countries would go beyond the capacity of this paper. Examples of development-oriented financial investment incentives contained in this study therefore represent interesting country-specific cases and should be considered as anecdotal evidence.

### **2.3 Incentives for investments in high-value added sectors**

The evolution from a structure of production based on unprocessed or low value added products to one based on higher value added products is one of the main challenges for developing countries to achieve their structural transformation and economic development. As discussed in the first chapter of this report, this priority is recognized also by the Structural Development Goals (SDGs), in particular by target 8.2 calling for “Achieving higher levels of economic productivity through diversification, technological upgrading and innovation, including through a focus on *high-value added* and labour-intensive sectors”; and by target 9.b calling for “Supporting *domestic technology development*, research and innovation in developing countries, including by ensuring a conducive policy environment for, inter alia, *industrial diversification and value addition to commodities*”(emphasis added).

In this sense, a common policy goal for most developing countries is to attract private investments in sectors and activities not yet developed in the country, aimed at the production of goods and services with higher value added and at the technological and knowledge upgrading of domestic physical and human capital.

The specific strategies historically and currently chosen by developing countries to reach these goals differ in terms of reliance on foreign direct investment (FDI) and associate spillovers on technology and knowledge transfer.<sup>26</sup> Nowadays it is more and more recognized that attracting FDI in mere assembly firms of imported parts and components may help creating employment for low-skilled workers (often low-quality employment) but does not help the process of learning and knowledge transfer.

Several developing countries have embraced these considerations into their investment codes and tax incentive structures through regulations reserving the fiscal benefits to firms involved in the production of higher value-added products and services. This is done generally by adding among the conditions to benefit from the tax discount a minimum threshold for the locally produced value added. In this way, firms engaged in pure assembly operations of imported inputs and components, or any other low-value added activity, are excluded from the preferential fiscal treatment.

As shown in Table 3, in Sub-Saharan Africa for instance Botswana allows manufacturing companies to pay a reduced 15% on corporate income (instead of the standard 22%) and defines manufacturing as the “processing of raw materials that result in the product having new and distinctive characteristics from the raw material from which it is made” (Manufacturing Approval Order, 1st July 1995, Section 52). The same law specifies that activities such as packaging, bottling, printing, polishing, dyeing or simple assembling operations are not regarded as manufacturing and are taxed at the standard rate.<sup>27</sup> Similarly, Ivory Coast requires that in order to benefit from the CIT exemptions specified by the Investments Code, investors must receive an approval released by the national investment promotion agency “based on the value added created in Ivory Coast and the economic and social development objectives” (Investment Code, 2012, Art. 39).

In other countries the requirement to create local value added is more stringent in that the fiscal advantage is conditional to generating locally a minimum amount of value added. The Republic of Cameroon for example includes in the conditions for private investment activities to benefit from various tax exemptions and reductions the creation of value added to the extent of 10 to 30% of turnover revenue excluding taxes (in alternative to the requirement to use domestic inputs to the extent of 10 to 25% of total inputs value). Similarly, in the Democratic Republic of Congo investing companies must create an added value of 35% of their initial investment in order to take advantage of a certain number of tax and duties reductions and exemptions.

As shown in Table 3, also some Asian developing countries have adopted fiscal incentives conditional to the locally generated value added. In Malaysia for instance

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<sup>26</sup> In chapter 1 (section 1) we have recalled Amsden’s distinction of developing countries between “independents”, i.e. technology-makers less reliant on FDI, and “integrationists”, technology-buyers more reliant on FDI.

<sup>27</sup> In Botswana for a company to be taxed under manufacturing, it must apply to the Finance minister who will send a team of experts to inspect the business to check if it meets the requirements. The team will then submit its findings to the minister to inform his/her decision.

manufacturing companies are eligible for an income tax exemption of 10% (or 15%) of the value of the increased exports provided the goods exported attain at least 30% (or 50%) of value added. Similarly, Sri Lanka offers tax rebates to manufacturers of any product having domestic value addition over 35% (if product is mainly sold in the domestic market) or over 65% (if product is exported or supplied to an exporter). Likewise, Thailand includes among the criteria to grant fiscal advantages to private investors a minimum threshold for the domestic creation of value added (20% or 10% of sales revenues depending on sector).

Note that the use of fiscal incentives conditional on the value added produced locally has two potentially counteracting effects. On one side, these fiscal incentives can attract investments in technically advanced production processes whose potential spillover in capacity building, technology transfer, and workers' training is higher than in simple assembly operations. On the other side, by excluding from the tax advantage firms operating in low value added activities like packaging, cutting, polishing, or blending ingredients, it is likely that local firms, which typically lack the technical capacity to operate in high value added sectors, have access to the preferential fiscal treatment proportionately less than foreign-invested firms.<sup>28</sup>

Moreover, many low value added activities like packaging, bottling, labeling, or catering can actually offer easy-entry possibilities for local firms to become suppliers to major foreign or domestic investors. In this sense, excluding low value added activities from the preferential fiscal treatment can actually go against the policy objective of integrating the domestic economy into global or local value chains.<sup>29</sup>

Since local firms tend to be small, a possible way out is to differentiate by firm size the tax incentives requirements based on local value added creation, by setting lower thresholds for SMEs. Malaysia for instance as of January, 1st 2016 reduced the value added thresholds for SMEs to enjoy a tax rebate for manufacturing firms exporting value-added products (KPMG, 2015). Given that domestic firms are mostly small and medium sized in developing countries, firm-size differentiated thresholds for value added requirements in investment incentives can help both attracting larger foreign and domestic investors engaged in higher-value added productive activities and at the same time supporting ancillary domestic industries involved in lower-value added productive activities.

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<sup>28</sup> For instance, it is reported by the Government of Botswana that the national brewer Kgalagadi Breweries Limited (KBL) in 2010 urged the government to tax some of its products, especially soft drinks, under manufacturing, a move that would have lessened the tax burden from 25 per cent to 15. At the time of the reported news, the government was unlikely to accede to KBL proposal (<http://www.gov.bw/en/business/business-news/kbl-wants-to-be-taxed-under-manufacturing/> retrieved in April 2016). Following sustained challenges in its trading environment (including the Traditional Beer Regulations implemented in 2012 to formalize the trade, effectively banning the sale of traditional beer in residential areas) five years later the national brewer had closed down two production plants (the first in 2013 and the second in 2015) with a total loss of almost 150 jobs (<http://www.businessweekly.co.bw/88-jobless-as-kbl-shuts-lobatse-plant/> retrieved in April 2016).

<sup>29</sup> Fitting with this observation, the African Transformation Report 2014 suggests that Botswana's "diversification priorities could focus in the short to medium term on garments and textiles, *packaging* food and beverages, *packaging materials*, leather, ceramics, jewelry, tourism and financial services" (African Center for Economic Transformation, 2014, p. 178, italic added).

## 2.4 Investment incentives for developing local supply chains

The development of local supply chains is a primary goal of policies aimed at structural transformation and inclusive development. In fact, the more large foreign-invested or domestic firms generate demand for domestically produced goods and services, the more production, employment *and learning* opportunities will be generated along the value chain. Demand linkages can be generated backward – through the demand for local raw materials, domestically produced parts and components, as well as intermediate services (such as laboratory analysis or quality testing) – and forward, for instance through the demand for packaging, transport or distribution services.

As we will see in this section, in order to develop local supply chains it is crucial to create the *opportunities* and the *incentives* for foreign and domestic investors to utilize in their production processes domestically produced intermediate goods and services. Moreover, in order for local supply chains to become an opportunity to develop *domestic* technological capabilities, it is important to foster *local* firms to be able to compete with foreign-invested (but domestically based) firms in the production of intermediate products and services. In this sense, investment incentives aimed at the development of local suppliers can be seen as development-oriented policy tools towards the achievement of the SDGs target 9.b calling for “supporting *domestic technology development*”.

Historically many developing (and developed) countries typically supported the development of local supply chains by granting private investors fiscal advantages under the condition to use local raw materials and local inputs. However, since the adoption of the SCM and TRIMs WTO agreements, “local content requirements” are no longer allowable. In fact, these agreements prohibit the use of subsidies contingent upon the use of domestic over imported goods (SCM) and the use of investment measures requiring the use of products of domestic origin to obtain an advantage (TRIMs). Developing countries who are members of the WTO or are willing to become members of the WTO had therefore to (or are in the process of) discontinue these measures after a given transition period. In some WTO-member countries, however, local content requirements are still in use either because the transition period has not expired yet or because the WTO-inconsistent investment measure was not notified to the WTO.

Table 4A and 4B show fiscal incentives conditional on different requirements addressing the development of local value chains, currently in use in a number of Sub-Saharan African and Asian developing countries.

As shown in the tables, the use of local inputs is used in several developing countries in both regions as eligibility condition for fiscal advantages. In Sub-Saharan Africa, for instance, Cameroon includes among the four alternative conditions to benefit from various tax exemptions and reductions the use of domestic inputs to the extent of 10 to 25% of total inputs value. Likewise, Ghana allows a reduced CIT rate (8% instead of the standard 25%) to companies engaged in the export of “non-traditional products”, defined as “horticultural products; processed and raw agricultural products *grown in Ghana* other than cocoa beans; wood products other than lumber and logs; handicrafts; and locally-manufactured goods.” Moreover, agro-processing companies, which use Ghana’s agricultural raw materials as their main inputs are allowed a reduced CIT rate varying between 0% and 20% depending on the location (after an initial tax holiday).



Similarly, Nigeria offers a tax credit of 20% for five years to companies utilizing a sector-specific minimum rate of local raw materials or locally produced inputs.<sup>30</sup>

Also in some Asian WTO-member countries local content requirements are still in use. As shown in Table 4B, in Bangladesh, for instance, some export-oriented industries are granted additional fiscal benefits upon the condition of using indigenous raw materials instead of imported materials.<sup>31</sup> Similarly, in the Philippines manufacturing companies engaged in specified priority activities enjoy one additional year of CIT exemption (after the initial 3 to 6 years) upon the condition to use indigenous raw materials for at least 50% of the total cost of raw materials.<sup>32</sup>

A somehow different way of stimulating the use of domestic inputs is to allow tax deductions for expenditures on locally manufactured intermediate goods. For instance, Table 4B shows that Sri Lanka and Thailand allow for a full 100% deduction from taxable income of expenditures on software and technologies developed in their respective countries. Although potentially these fiscal measures could be interpreted as WTO non-compliant, they are probably more compatible with the WTO regulations than straightforward local content requirements.

A part from the fact of not being WTO-compliant, there is a more substantial reason why fiscal incentives conditional to the use of local inputs can be only partially effective. In fact, if providing incentives for foreign and domestic investors to buy domestically produced inputs is important, equally important for the efficacy of the policy provision is to provide them with the *possibility* of doing so. In order for large companies to use locally produced inputs, or to buy satellite services from local providers, it is essential for the local suppliers to be able to produce goods or provide services timely, in the right quantity and with the required quality characteristics. Since in developing countries domestic production of industrial inputs is usually underdeveloped, this is often not the case. If local manufacturers or service providers do not satisfy these requirements, or simply are not there, large foreign-invested and domestic companies *have* to rely on imported inputs.

Still, buying inputs locally could be more cost-efficient for large companies than importing them, setting in a virtuous circle between large companies and local suppliers of inputs and components. This is of course a crucial opportunity for expanding the country's production and technological capabilities and generating productive employment.

A first logical option is therefore to offer tax discounts, enhanced tax deductions, or financial incentives directly to firms *producing* intermediate goods and services, rather

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<sup>30</sup> Cameroon, Ghana and Nigeria are WTO members and are included in the latest official updated list of non-LDC countries with a per capita GNP below US\$1,000 (WTO, 2013). As such, they are granted 5 years to eliminate any notified WTO-inconsistent trade-related investment measures (according to TRIMS) and to phase out any prohibited local content subsidy (according to SCM). None of them however notified the WTO of any WTO-inconsistent trade-related investment measure.

<sup>31</sup> Bangladesh is WTO member included in the UN list of least-developed countries (LDCs). As such, Bangladesh is granted 7 years to eliminate any notified WTO-inconsistent trade-related investment measures (according to TRIMS) and 8 years to phase out any prohibited local content subsidy (according to SCM). Bangladesh however did not notify the WTO of any WTO-inconsistent trade-related investment measure.

<sup>32</sup> The Philippines have officially overpassed the threshold of US\$1,000 for three consecutive years (2009-2011) and therefore do not longer qualify for the "Special and Differential Treatment" included in the WTO TRIMS and SCM regulations.

than *buying* them. By offering the fiscal (or financial) advantage to the (domestic and foreign) *suppliers* of intermediate goods rather than (only) to the *buyers* of domestically-produced intermediate goods, these incentives could have the double advantage of supporting the development of local supply chains, at the same time as being a measure not contrary to the provisions of the SCM and TRIMs WTO agreements. Yet in our survey we found only few examples of countries offering fiscal incentives to (local and foreign) companies *supplying* their production to other companies based in the country (Ethiopia and Nigeria in Sub-Saharan Africa, and Bangladesh, Cambodia and Vietnam in Asia).

At the same time, tax reductions and deduction allowances may not be sufficient to support the development of *local* manufacturers of intermediate goods and providers of intermediate services. Often, in fact, in developing countries local suppliers are small and medium enterprises, lack access to capital and modern technology, and are weak in management experience and human resources. Allowing tax incentives for investors in intermediate goods and services sectors is therefore not sufficient to stimulate the development of *local* firms in the targeted intermediate goods sectors. Without the government support to access credit, technology and human resources, local suppliers will not be able to supply large multinationals with the required quality and quantity of intermediate goods and services. The efficacy of the fiscal incentives will be therefore reduced to the attraction of new *foreign-invested* companies in the specified intermediate-goods sectors. This in turn can have beneficial effects through the generation of employment (provided that the domestic labor force has the necessary skills) and the penetration of new technologies in the country, but will fall short of the initial objective of supporting the development of *local* manufacturers of intermediate products and services.

Possible government interventions to support the development of local suppliers include on one side incentives to stimulate banks to supply loans to local suppliers and other forms of financial incentives (see section 5.2), and on the other side incentives for *large firms* to invest in technology transfer, training and financial assistance *to their local suppliers*. In our analysis of tax regulations, we could find two examples of the latter form.

The first is in Papua New Guinea, where agricultural companies are allowed a 150% deduction on expenditures to provide advice, training, and technical assistance to smallholder growers on production, processing, packaging, and marketing issues. The second example is Thailand, which allows a 100% deduction of expenses incurred for development of local suppliers with not less than 51% Thai shareholding in advanced technology training or technical assistance (see last column of Table 4B). This kind of tax incentives could be expanded to include the expenditures incurred by major companies in assisting and auditing their suppliers to adhere with the company's quality, environmental, health and safety standards.

In the context of structural transformation strategies based on the development of agro-related sectors, policies for the development of local suppliers and knowledge transfer could also consider the use of fiscal or financial incentives to promote outgrower schemes. Outgrower schemes are a type of contract farming where farmers produce on their own land under contract, and agro-processing companies provide them inputs and technical support and guarantee to buy the growers' crop subject to meeting predefined

standards (TechnoServe, 2011).<sup>33</sup> Subject to certain conditions, outgrower schemes have proved successful in generating mutual benefits for the processors – who can obtain inputs locally at a lower price than importing them or without investing in commercial production, and have higher control over sourcing (variety, quality control, timing, food safety, traceability) – and for the growers, who receive higher quality inputs and technical assistance and can increase their income security. Moreover, as observed by TechnoServe (*ibid.* 2011, p.5): “an overwhelming majority of the buyers surveyed for this brief cited the provision of extension services as critical to the success of their outgrower schemes. A large majority expressed a willingness to invest up to 10 percent of the market value of sourced products to ensure effective extension services.” This observation is particularly interesting as it points to the possibility to offer fiscal or financial incentives to private companies investing in agro-processing sectors *conditional* to the use of outgrower schemes or to the provision of extension services to the contracted smallholder farmers. In this way, the incentive could catalyze investments generating strong linkages with and knowledge transfer to the local smallholders.

Note moreover that the transfer of technological and business know-how can flow along the value chain not only backward (from foreign and domestic investors to the local suppliers of intermediate goods and services) but also sideward (through joint-ventures with local partners) and forward (for instance through franchising business models). Investment policies aiming at technological and business know-how transfer could therefore include fiscal or financial incentives for companies adopting joint venture and franchising business models involving local firms. For instance, in Sri Lanka joint ventures between tea growers or manufacturers and tea exporters for exporting Sri Lankan tea in value added form, enjoy a reduced CIT rate (see last column of Table 4B).

As for franchising, we could not find any example of fiscal or financial incentives to support this kind of business models. And yet, there is evidence that franchising – especially micro-franchising – can be a successful business model for inclusive development (Fields, 2012). In micro-franchising the franchisors provide the micro-franchisees (self-employed people and micro-entrepreneurs) with business know-how, start-up assistance, financing, training, equipment, raw materials, quality standards directions and marketing support. There are several micro-franchising examples in the developing countries that proved to be profitable for both sides, and to create substantial number of jobs.<sup>34</sup> It would seem therefore beneficial to use fiscal or financial incentives to stimulate the expansion of micro-franchising in developing countries.

## 2.5 Investment incentives for the promotion of quality-certified production

Besides setting up incentives to harness the profit-maximizing thrust of large firms as sources of knowledge and technology transfer to their local suppliers, the development of local suppliers can be promoted by offering fiscal incentives to companies achieving international quality standards and related certifications for their products. In fact, in order to supply multinational companies, local manufacturers of intermediate goods must meet international technical standards and provide a certificate of conformity.

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<sup>33</sup> In outgrower schemes usually growers receive a pre-agreed percentage of the final sales price of their product, thus leaving them still fully exposed to price risk (TechnoServe, 2011, p. 1).

<sup>34</sup> For a discussion of successful examples of micro-franchising in the developing world see Field (*ibid.*: pp.176-177).

Moreover, in order for local companies to be able to export and succeed in globalized markets the quality of the product is essential. This is true in any sector, from manufacturing to services and agricultural products. In particular, in low-income countries whose development strategy is based on developing agro-processing industries, this is even more important in that international quality standards for processed agricultural products are even higher due to health-related regulations.

In turn, successful local producers of quality-certified products are a very important source of employment opportunities in the country. Additionally, the release of international quality standards certifications requires the development of a network of quality testing and calibration laboratories, which could be supported through appropriate fiscal or financial incentives. Besides enhancing the quality of domestically-produced products, this could create new job opportunities for laboratory technicians and analysts (provided that appropriate technical schools are developed).

The importance of quality certification both for structural transformation and employment creation is not commonly acknowledged in developing countries' incentives structure.—Some developing countries in fact do include the promotion of quality certification in their national industrial policy strategies, and in some cases even have a national quality policy, but rarely include quality certification incentives in their investment promotion laws. For instance, Ghana's National Industrial Policy includes among its objectives the "development and effective use of national standards, based on relevant international standards, for production", which is recognized to "play a key role in promoting industrialization" (Ghana Ministry of Trade and Industry, 2010, p.20). Similarly, Nigeria, Rwanda, and Uganda have a National Quality Policy. However, to the extent of our knowledge, none of these countries have introduced fiscal or financial incentives aimed at promoting quality certifications.

In contrast some other developing countries, particularly in Asia, have adopted incentives designed to encourage companies to produce in conformity to international quality standards. As shown in Table 5, in Malaysia companies can claim a double deduction of the expenditure incurred for the purposes of obtaining recognized quality systems and standards and halal certification.<sup>35</sup> Moreover, in Malaysia some expenditures for the promotion of exports are eligible for double tax deduction only for products of "export quality", defined as the products being already exported or, if not yet exported, having acquired international quality certification.<sup>36</sup>

Similarly, in Thailand projects approved by the Board of Investment giving access to several tax and non-tax incentives must obtain a certification, such as ISO 9000, ISO 14000, or similar international standard certification within two years from the full operation start-up date, otherwise the CIT exemption is reduced by one year. Furthermore, Vietnam has recently introduced a set of fiscal incentives for manufacturing companies whose products support the high technology sector and other selected industries, and has made these incentives conditional on the requirement that the products meet the technical standards of the European Union.

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<sup>35</sup> Halal Certification is a recognition that the products are permissible under Islamic law. These products are thus edible, drinkable or usable by Muslims.

<sup>36</sup> The international quality certifications needed in Malaysia for a product to be recognized of "export quality" include European Conformity Mark (CE Mark), Hazard Analysis And Critical Control Points (HACCP), Japanese Industrial Standards (JIS), European Standard (EN), Quality Standard (QS) and International Organization for Standardization (ISO).

Beyond using quality-related fiscal incentives, developing countries can use quality-related *financial* incentives to encourage companies to obtain international quality standard certifications. India for instance runs an incentive scheme for small-scale firms providing the reimbursement of 75% of the expenses of acquiring international certifications of quality management (ISO 9000 and ISO 9001), environmental responsibility (ISO 14001 EMS) and food safety in production processes (HACCP).

Last, but not least, developing countries can support the diffusion of international quality standard certification of national products by offering fiscal and financial incentives to set up companies *providing* quality certification services. As explained above, stimulating the supply – as well as the demand – of certification services can have a significant return in terms of job creation and employment opportunities for skilled workers. To the extent of our knowledge, only Malaysia’s 2016 budget (presented on 23 October 2015) includes among a broad range of tax incentives for individuals and businesses a set of tax incentives for the establishment of “Independent Conformity Assessment Bodies” (ICAB), defined as companies “providing conformity assessment services by testing products, materials, systems or services for conformance to international specifications or safety standards and other conformities” (KPMG, 2015).

In sum, the promotion of international quality standard certification can benefit developing countries significantly both in terms of production and employment growth. As already done in some Asian developing countries, tax incentives can be offered to firms obtaining international standards conformity certifications, for instance by allowing the deduction of investment expenditures incurred for adapting products to international standards and for obtaining the certification. Tax incentives can also be offered to companies providing consulting and certification services to firms willing to obtain international quality standards certifications. Moreover, tax incentives can be accompanied by financial incentives to provide firms obtaining international quality certifications with easier and cheaper access to bank credit. More generally, given the high potential of quality certification in terms of development and employment creation, a task force on quality policy can be created involving all stakeholders (ministries of labour, education, industries, finance and development, as well as the private sector).

The synoptic table 6 summarizes the results of the previous three sections, by showing the different kinds of fiscal and financial incentives aimed at the production of higher value-added goods and products, the development of local supply chains and the upgrading of domestic technology.

Up to this point our analysis of tax regulations has shown that while in developing countries sector-based fiscal investment incentives are still very common policy tools, often developing countries try to attract foreign and domestic investments with higher potential positive spillovers on the country’s development by switching from simple sector-based or location-based fiscal investment incentives, to fiscal incentives conditional to some measurement of the impact on the local economy.

In order to promote the diversification of the national production structure towards higher value added goods and services, some developing countries have introduced fiscal investment incentives conditional upon the local creation of value added. This has the advantage of discouraging pure assembly operations of imported inputs and components, but has the disadvantage of excluding from the fiscal benefits low value-added activities where local firms are typically concentrated. A possible improvement in this situation is to allow SMEs to access the tax discounts starting from lower local value added thresholds than those set for large firms.

Developing countries also use investment incentives with the aim of developing local supply chains. Since local content requirements are no longer allowed under WTO regulations, a tendency emerges among some developing countries to shift the beneficiaries of the fiscal incentives from the buyers to the suppliers of inputs and intermediate products and services. This is a favorable change for the deepening of local value chains, although the development of local suppliers requires several further types of government support beyond tax discounts. As regards the use of fiscal (or financial) incentives to promote the capacity building and upgrading of the local suppliers, this section has discussed the possibility to introduce enhanced deductions from taxable income of expenditures incurred by companies in providing training and technology transfer to local suppliers, or incurred by companies achieving international quality certifications, as well as incentives for business models such as outgrower schemes, micro-franchising or joint ventures involving knowledge transfer to local firms (especially SMEs). More generally, the development of local value chains requires the support of small and medium enterprises (SMEs) with various government policies. In the next section we turn to see how and to what extent fiscal incentives are used to support SMEs in developing countries.

## 2.6 Fiscal and financial incentives to promote SMEs development

In developing countries, small and medium enterprises (SMEs) often account for the majority of economic output and employment, so countries aiming at transforming into advanced economies and at the same time achieving inclusive job-rich growth must include in their priorities the support to SMEs development. The importance of SMEs for employment and GDP growth is largely recognized by developing countries governments, as shown by most official SMEs development policies. Moreover, the SDGs explicitly indicate the necessity to promote “development-oriented policies that support productive activities, decent job creation, entrepreneurship, creativity and innovation, and *encourage the formalization and growth of micro-, small- and medium-sized enterprises, including through access to financial services*” (SDGs Target 8.3).

The policy areas involved in national SMEs development plans are varied and range from building human capital, entrepreneurial and financial skills, to developing and facilitating access to physical and technology infrastructures, providing business enabling legal and regulatory frameworks for SMEs, facilitating SMEs access to financing, commercial land and markets, supporting SMEs technology upgrading, innovation and creativity, or creating SMEs incubation centres. In some cases, the national SMEs development policies can have an explicit employment creation target. This is the case for instance of Papua New Guinea’s SME Policy launched in March 2016, which has set the goals to grow by 2030 the number of SMEs from 49,500 to 500,000 and formal employment from 290,000 to 2 million, as well as to increase SME contribution to GDP from 6% to 50% and per capita income from US\$2,000 to US\$9,600 (Papua New Guinea Ministry of Trade, Commerce and Industry, 2016, p. 8).

### 2.6.1 Fiscal incentives to promote SMEs development

Fiscal incentives are among the possible policy instruments that countries can use in different policy areas to support SMEs development. The optimal nature and timing of SMEs-specific fiscal incentives of course depends on a country’s degree of inclusion in the tax net and compliance capacity of SMEs. In low-income countries, where small businesses mostly operate in the informal sector and lack the capacity of properly keeping accounting records and calculating tax liabilities, often governments introduce a presumptive tax for SMEs based on a percentage of the estimated turnover, with the aim

of including SMEs into the tax net but at the same time reducing their tax burden and compliance costs. In this stage of development, fiscal incentives for investments in priority sectors tend to be limited to large investors, although SMEs can (and should) be included among the eligible recipients of the investment incentives in priority sectors. In middle income countries, where small businesses have higher capacities and degrees of compliance, governments tend to adopt reduced CIT rates for SMEs, include SMEs in fiscal incentives for start-ups in priority sectors, and offer SMEs enhanced expenditure-based deductions.

Our survey of tax legislations in Sub-Saharan African, South Asian and South-East Asian developing countries reflects these trends as well as some regional tendency. First, Table 7 shows the higher frequency of turnover tax regimes for micro and small businesses in sub-Saharan African countries (Ethiopia, Ghana, Nigeria, Rwanda and South Africa<sup>37</sup>) and of reduced CIT rate regimes in Asian countries (adopted in all 9 Asian developing countries considered).

Beyond providing special tax regimes for SMEs, developing countries can support the growth of SMEs in priority sectors by including in the investment codes and other investment laws special reduced requirements for SMEs to access the fiscal incentives offered to all (or large) investors embarking upon projects in priority sectors or activities, as well as special fiscal incentives offered only to SMEs.

Table 8 shows different SMEs-related fiscal incentives in selected Sub-Saharan African and Asian developing countries. As regards the minimum investment thresholds required to access the fiscal benefits of the investment codes, some developing countries have rules establishing that only large investors are eligible for fiscal investment incentives. In Rwanda, for instance, the Investment Promotion and Facilitation Law of 2015 requires to invest the equivalent of at least ten million US Dollars in Rwanda to enjoy a preferential corporate income tax rate of zero per cent (0%), and the equivalent of at least fifty million US Dollars in specified sectors, including manufacturing and tourism, to be entitled to a maximum of seven years corporate income tax holiday.

In other countries, no minimum investment is required by the investment codes for the eligibility to investment incentives, but the process to qualify for the benefits of the investment law can require the approvals of different government bodies, making it often difficult for SMEs to access the investment incentives. This is the case for instance of the investment laws of Botswana and Cameroon.

In contrast, some countries offer explicitly SMEs-oriented fiscal incentives by making the requirements to access the benefits of the investment laws differentiated by firm size, with lower thresholds for SMEs, as well as offering SMEs-specific investment incentives. In sub-Saharan Africa this is the case of Congo, Ivory Coast and Senegal.<sup>38</sup> In particular, Ivory Coast's investment code of 2012 includes a section on SMEs, where it is regulated that SMEs not only can enjoy various tax reductions and exemptions for longer time periods than large firms, but also have access to additional specific benefits such as

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<sup>37</sup> Nigeria and South Africa, respectively lower middle income and upper middle income countries, provide both a presumptive tax regime and a reduced CIT rate regime for small companies. Note however that as of May 2016 the Nigerian presumptive tax regime is not yet operational.

<sup>38</sup> In order to grant tax holidays to companies in eligible pioneer industries Nigeria requires a higher investment threshold for foreign-owned companies than for indigenous companies. Although indigenous companies tend to be smaller, this rule is not in the first place aimed at facilitating SMEs development.

access to government land to set up investment projects and lower tariffs for electricity, water and “new technology” services.<sup>39</sup> Similarly in Asia, Malaysia has recently approved the reduction for SMEs of value added thresholds to access the tax discount offered to all manufacturing companies exporting value-added products; and Papua New Guinea is developing a proposal for a 5 year start up tax holiday for micro and small businesses.

Further, as shown in Table 8, some upper middle income countries such as South Africa, Malaysia and Thailand have introduced SMEs-specific expenditure-based incentives in the form of enhanced deductions for R&D expenditures undertaken by SMEs (Malaysia) and higher depreciation rates of capital assets for SMEs (South Africa and Thailand).

Finally, in the context of SMEs development policies for structural transformation and local supply chain development, it is worth mentioning the important role that large companies can have in acting as mentor and advisor to smaller companies. Governments can therefore include in their policies for SMEs development measures to support large companies involved in the promotion of small companies. For instance, as shown in Table 8, Papua New Guinea's SMEs development policy (launched in March 2016) includes a proposal of tax credits for large companies who provide patronship, mentoring or business development services to grow SMEs. With a similar rationale, the Government of Botswana has launched in November 2013 in partnership with the companies Anglo American, De Beers and Debswana an enterprise development programme called Tokafala, aimed at promoting the growth of micro, small and medium-sized companies in Botswana. The programme offers mentoring and advisory services, aimed at empowering entrepreneurs with the right financial and business skills to run a growing business and to expand their market access.<sup>40</sup>

Table 9 summarizes the findings of this section. Taken together, our analysis suggests that in low and lower middle-income countries – where the main policy objectives in regard to SMEs include joining SMEs into the tax system and creating employment opportunities – fiscal incentives tend to focus on offering reduced CIT rates (or presumptive taxation) for SMEs. At this stages of development, introducing different CIT rates for micro, small and medium enterprises can not only give incentive to the formalization of existing informal small businesses, but also encourage micro-entrepreneurs (including women and youth) to embark upon new projects, creating employment opportunities. Moreover, low- and lower-middle income countries whose development strategy is based on agro-allied activities, tourism and rural development, can offer temporary exemptions from income tax to SMEs start-ups engaged in labor-intensive sectors such as artisanal activities, small-scale hotels and services for ecotourism and adventure travel (such as certified tourist guides, rental services of bikes or kayaks, or training schools for guides and specialized personnel) as well as to SMEs engaged in environmental protection or cultural heritage preservation activities. At the same time, small agro-related businesses could be offered enhanced deductions for expenditures incurred for obtaining internationally recognized organic production certifications.

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<sup>39</sup> Ivory Coast's Investment Code (2012), articles 47-49.

<sup>40</sup> For further information, see [tokafala.co.bw](http://tokafala.co.bw).



In lower- and upper-middle income countries the policy objectives in regards to SMEs gradually shift from formalization and employment generation to the enhancement of SMEs capacities in terms of value added creation, participation in global value chains, use of advanced technology, innovation and creativity, and creation of productive employment for skilled workers. In this context, fiscal incentives for SMEs can be offered to high-tech SMEs start-ups engaged in information technologies, telecommunications, biotechnologies, or new materials development, or be based on value added created, international quality-certifications, number of high-skilled workers employed, ownership of highly-skilled professionals returning to their own country, and any other quality and technology-related requirement.

Similarly, enhanced tax deductions can be introduced for expenditures incurred by SMEs to upgrade their machineries and technology, achieve international quality standards certifications, participate in international trade fairs and training courses, or any other quality and technology-related expenditure. This is particularly important, as SMEs have limited information and access to funds, so typically adopt a short-term strategy by minimizing capital investment with the objective of keeping the cost low. This approach in the medium run brings many small suppliers to the lower end of the global value chain and ultimately makes them uncompetitive (Government of India, 2010, p.7). Last, but not least, tax deductions and reductions can be offered to large firms engaged in the development of their SMEs suppliers.

## 2.6.2 Financial incentives to support SMEs access to credit

If making fiscal incentives more SMEs-oriented is a priority for promoting inclusive development, on the other side fiscal incentives alone are not sufficient to trigger the development of SMEs and their technology upgrade. Even when SMEs comply with tax obligations and can therefore benefit from fiscal incentives, in fact, they often lack the capacities to develop beyond a certain level so that their employment generation potential gets eventually restrained. In particular, the most common issue constraining SMEs growth is access to credit. For this reason, many developing countries employ financial incentives in their policies for SMEs development, in order to help SMEs gathering the financial assets needed for their birth or growth.

Table 10 shows different kind of financial incentives used by developing countries in support of SMEs development, and their possible outcomes in relation to different policy objectives, agents and stages of development.

The type of credit available to SMEs – and correspondingly the appropriate policies to address the SMEs financing gaps – vary with the country's level of income and financial development as well as with the enterprise's characteristics (Asian Development Bank, 2015, pp.20 and 32-33). In low income countries most SMEs are microenterprises and rely on their own capital and informal lending for their business operations. In this stage of development, SMEs finance policies generally focus on micro-finance, as well as on financial incentives like government-based grants and concessional lending schemes for SMEs start-ups. These have the advantage to support financially the growth of SMEs according to specified policy objectives, such as employment generation and youth or women entrepreneurship, but can fall short of selecting the most productive and long-run resilient projects.

In order to increase the resilience of government-financed SMEs, government financing schemes can be coordinated with programs offering small entrepreneurs financial and entrepreneurial education, as well as access to infrastructures, technology, international quality certifications or international trade fairs. Moreover, government

grants and concessional loans can be designed to include additional requirements, as for instance international quality-certifications, or ownership by highly-skilled professionals returning to their own country. Further, with the aim of selecting the most productive and resilient projects, governments can implement “matching grants” in partnership with private philanthropy foundations and “social impact investors”.<sup>41</sup>

In this context, a further possibility is to provide leasing schemes to SMEs for technology upgrading. For instance, the Development Bank of Ethiopia's Lease Financing Policy for Middle Level Enterprises (MLEs) recently approved will provide lease financing to MLEs to buy machineries, and cover 80 per cent of their cost for the procurement of machinery without collateral.<sup>42</sup> Finally note that educational programs for small entrepreneurs, together with simplified procedures and dedicated desks for vulnerable micro-entrepreneurs, would also be needed to decrease the risk of middlemen appropriating illegally part of the grants.<sup>43</sup>

As a country's economy proceeds towards lower-middle income status, SMEs generally get involved in more complex manufacturing activities, have higher technology requirements, employ more workers, and require larger amounts of financing for the acquisition of new machinery or the expansion of their activity. Often, however, at this stage of development many SMEs still do not keep accurate financial accounts, lack real estate collaterals, or work in unsecure financial conditions (for instance by accepting post-dated checks<sup>44</sup>), so that banks consider lending to SMEs at higher risk and can be reluctant to lend. In order to alleviate the financing gap faced by SMEs, government policies in low-middle income countries therefore generally focus on enhancing SMEs bankability through incentive schemes like loan guarantees and targeted refinancing lines, aimed at raising the supply of bank credit to SMEs (sometimes with a focus on young or women entrepreneurs).

Through loan guarantees a guarantor agency (the government, the central bank or a development financial institution) agrees to pay back the loan (up to a certain percentage of the loan) in the case that the borrower does not pay back its loan or the interests on it. Under a refinance scheme a government agency, normally the central bank or a public development bank, offers a loan (refinance scheme) at a favorable interest rate to the commercial banks, or other eligible non-bank financial institutions, that have provided loans to companies in targeted sectors and activities, for up to a certain percentage of the loans outstanding to eligible borrowing institutions. So refinance schemes differ from loan guarantees in that the credit risk of the underlying loan(s) against which refinance is extended remains fully with the commercial bank.

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<sup>41</sup> Social impact investment is a new trend in private-sector finance, in that a growing number of private and institutional investors look for profitable investment opportunities that have not only an economic return but also a social impact.

<sup>42</sup> Addis Ababa Chamber of Commerce and Sectoral Associations, January 2016, <http://www.addischamber.com/index.php?subPageName=macNews&newsID=56>.

<sup>43</sup> A warning against the existence of middlemen under India's Prime Minister's Employment Generation Programme (PMEGP) is found in the website of the Khadi and Village Industries Commission (KVIC) of the Government of India ([http://www.kvic.org.in/oldwebsite/index.php?option=com\\_content&view=article&id=231&Itemid=145](http://www.kvic.org.in/oldwebsite/index.php?option=com_content&view=article&id=231&Itemid=145), visited on May, 15 2016).

<sup>44</sup> The observation that small businesses, even if formal, run into financial problems due to the common practice to sell for post-dated checks is based on a personally conducted interview with the owner of a formal 40-employees garment manufacturing firm based in Sri Lanka. On the high incidence of post-dated checks in Sri Lanka see also Central Bank of Sri Lanka (2010, p.5).

For instance, the Small Industries Development Bank of India (SIDBI) runs a refinance scheme with the objective of increasing the flow of bank funds towards the setting up of new small scale units or the expansion, modernisation, diversification of existing small scale units. Similarly, the Bank of Bangladesh (BB) runs several targeted refinancing lines with the objective of increasing the flow of bank funds towards different sectors and prioritized investment projects, such as SMEs, new small entrepreneurs aged 18 to 45 years, women entrepreneurs (see Box 1: “Bank of Bangladesh Women Entrepreneurship Scheme”). Further, BB’s current refinancing lines include USD refunding at reduced interest rates to financial institutions who provide USD loans for import materials to certain export-manufacturers; refinancing lines to promote loans to the jute sector; refinancing lines to promote bank loans for solar energy, biogas, and effluent treatment green projects, and other green initiatives including water and energy use efficiency measures in the textiles industry.

### **Box 1: Bank of Bangladesh’s Women Entrepreneurship Scheme**

The Women Entrepreneurship Scheme launched by the Bangladesh Bank (BB) in 2007 provides a good example of financial incentive (refinance scheme) used to achieve inclusive development and structural transformation objectives.

**Motivation:** “As entrepreneurs grow from micro- to small and medium-sized enterprises, their financing needs are no longer met by microcredit, and they seek larger, commercial bank loans. This transition can be difficult for women, due to low financial literacy, as well as traditional norms that constrain borrowing and lending behaviour. Further, in order to expand production, rent new facilities, employ workers, and enter export contracts, small firms often must move from the informal sector to the formal economy. In that process, women in particular face not only regulatory and governance hurdles, but other social barriers and discrimination as well” (Schleifer and Nakagaki, 2014).

**Description:** Within the refinance scheme for SMEs development funded by BB, BB instructed commercial banks and non-bank financial institutions:

1. To allocate minimum 15% of total SME refinance funds to women entrepreneurs in SME sector.
2. To apply for credit to women entrepreneurs a capped interest rate (Bank rate – at the time 5% – plus maximum 5%; in any case not more than 10%).
3. To accept and settle all types of loan applications of women entrepreneurs in SME sector with high priority.
4. To take initiative to advertise all the facilities for women entrepreneurs in both electronic & print media.
5. Banks and Financial Institutions can provide a maximum loan facility of Tk.25 lac against personal guarantee if borrower is woman or maximum share of the enterprise held by woman.
6. To establish special advice and service centre for women entrepreneurs in selected branches; ensure service friendly approach towards women entrepreneurs.

**Impact:** According to the Bangladesh Central Bank, \$93 million in loans to small and medium enterprises was provided to almost 10,000 women by 2014, helping create tens of thousands of new jobs.

**Official recognition of achievement:** The Bank of Bangladesh’s Women Entrepreneurship scheme resulted from policy advocacy by Selima Ahmad, founder of the Bangladesh Women’s Chamber of Commerce and Industry. Selima Ahmad received the Oslo Business for Peace Award 2014.

Source: Central Bank of Bangladesh, [https://www.bb.org.bd/aboutus/dept/dept\\_details.php](https://www.bb.org.bd/aboutus/dept/dept_details.php)

Based on the extensive experience of Bangladesh Bank with refinance schemes, Barkawi and Monnin (2015, p.12) describe the pros and cons of this instrument to catalyse bank loans and investment projects into targeted sectors as follows. Among the pros, first is the fact that the default risk remains with the banking sector: commercial banks decide whether to provide a loan or not, based on its economic sustainability. Second, the discounted rate offered through targeted refinancing lines makes banks aware of new possible loan opportunities, helping to building up new credit markets.

Third, establishing an initial banking relationship allows borrower firms to get lower rates, less collateral requirements and larger loans in the future.

Among the cons, Barkawi and Monnin (*ibid.* p.12) include the risk of rent-seeking; the need for Central Bank to increase monitoring (as funds from refinancing lines may not be used for their intended purpose); and, last but not least, the fact that the availability of a refinancing line may not be sufficient for commercial banks to supply loans to the targeted sectors. In this regard, decisive factors include the discounted rate offered for refinancing, the maximum commercial rate allowed under the scheme, transaction costs, and the risk of default in target sector.

The fact that with refinancing lines and (to a lower extent) loan guarantees the banking sector is responsible for the decision to provide loans has twofold effects. On one side, if designed in a SMEs-friendly way, loan guarantees and refinancing lines can induce commercial banks to supply loans to small businesses, and the bank screening process should help selecting the most dynamic and profitable projects, which can create resilient growth and employment opportunities in the economy. On the other side, small firms at the lower-end of the SMEs spectrum would still be left out from bank credit, due to the lack account books and real estate collaterals, unsecure financial situation or lack of financial education. An interesting example in this regards is the experience of India's Technology Upgradation Fund Scheme (TUFS) for the textile industry, described in Box 2.

Hence, if the policy objective is the start-up or expansion of the most dynamic (hence suitable for bank credit) small and medium businesses in order to develop their productive capacities and generate productive employment for skilled workers, then loan guarantees and refinancing lines are appropriate instruments, supported possibly by the creation of special rating agencies for SMEs. On the other side, if the policy objective is to support the viability, technological upgrading and employment potential of small businesses which are too large to qualify for micro-credit and too small or unsecure to qualify for bank credit (the so-called "missing middle"), then government policies should focus more on providing financial literacy and business education, developing non-bank financing (such as by supporting lease financing and micro-financing institutions lending to small firms) and supporting alternative loan products (such as by introducing regulations to use alternative collaterals, like commercial invoices issued by SMEs suppliers of major companies, as in supply chain financing).<sup>45</sup>

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<sup>45</sup> For a through discussion of innovative financial instruments to support SMEs development see Magariños (2015).

### **Box 2: India's Technology Upgradation Fund Scheme (TUFS) for the textile industry**

The Government of India's Technology Upgradation Fund Scheme (TUFS) for modernization of the Indian Textile Industry was introduced in 1999 and subsequently revised and extended until the current 2015 version, which will expire in 2017.

Under the TUFS, the central government of India offers an interest reimbursement between 2% and 6% (depending on the on the sub-sector and the type of machinery) to textile companies when they take loans from banks and financial institutions to upgrade specified machinery in their factories. So de facto the scheme provides an interest subsidy reducing the actual interest rate paid by the textile companies when they take up loans to upgrade their technology. The program also includes 10%-15% capital subsidy for buying specified state-of-the-art machinery in sub-sectors.

What is interesting about this scheme is that the benefit goes directly to the targeted group. However, in its original version the scheme did not offer differentiated interest reimbursements to different sub-sectors of the textile industry, but offered a flat 5% interest reimbursement to all textile companies taking on loans for technological upgrading. What happened then is that the spinning sector, which is capital-intensive and mainly composed of big companies listed on the stock exchanges, took the largest share of the loans (around 33%), while the processing and weaving sectors, where more than 60% of the units are small businesses, received in the first seven years of the program only 11% and 7%, respectively of the total loans given under the scheme.

The under-performance of the scheme in the weaving and processing segments was due on one side to the fact that these segments are more labour intensive, but also to the fact that in these segments prevail small businesses, and many of them may not even have bank accounts and would not be able to produce a balance sheet for taking loans. The Government of India tried to correct the investment bias toward spinning, by lowering the interest reimbursement available for the spinning mills, and by increasing the interest reimbursement offered to weaving and processing units. This surely helped channelling larger financial flows into weaving and processing segments, but still could not solve the problem of small businesses unable to take bank loans because they have no bank account or are not creditworthy in the eyes of commercial banks.

Source: Government of India, Ministry of Textiles, <http://texmin.nic.in/schemes/technology-upgradation-fund-scheme>

## **2.7 Investment incentives with direct employment targets**

As discussed in the previous sections, fiscal and financial incentives can be used to stimulate private sector investment in specific sectors (agro-allied, industrial, or services), specific firm sizes and types (such as SMEs or domestically-owned hi-tech firms), or specific expenditures (such as technology upgrade or training expenditures). These incentives are introduced with the aim of steering private investment towards the achievement of country-specific goals such as industrial diversification, production of higher-value added goods and services and domestic technology development, and – if appropriately designed and accompanied by other supporting policies – can also have a positive impact on employment creation.

In some cases, fiscal incentives can be used with the aim of reaching specific employment objectives, so that the creation of employment is not an indirect consequence of the incentive measure, but *a requirement needed in order to qualify for the incentives*. Employment objectives can vary depending on the country's level of development and specific situation, from creating employment in specific sectors or areas, to generating employment opportunities for specific types of workers such as highly educated workers, young people or women.

In our analysis we found some instances of fiscal incentives directly linked to employment generation (shown in Table 11). Notably, India maintains a hiring incentive scheme, allowing manufacturing firms for a deduction from taxable income of 30% of the additional wages paid to the new regular workmen employed in the previous year, for three assessment years, provided that the factory employs at least 50 workers and raises the number of regular workmen by at least 10%. Interestingly, the provision – originally

offered only to corporate firms in the manufacturing sector employing at least 100 workers – was recently extended to *all* manufacturing units and the firm-size threshold was decreased from 100 to 50 regular workers (the amendments took effect as of April 2016).<sup>46</sup>

Moreover, a 11-member committee recently set up by the Indian government to suggest employment generation strategies, has included among its recommendations the extension of this tax benefit to the services sector, which is a major employer, and to contractual workers, given that firms tend to contract out the work rather than hiring regular workers. In addition, the employment-generation strategies panel suggested the Indian government to extend the incentive to all additional emoluments, instead of only additional wages, and to decrease the hiring threshold to a minimum increase of 2% in workforce instead of 10%.

The panel also called for extension of the interest subvention scheme (providing loans at 3 per cent lower than the prevailing rates) to all micro, small and medium enterprises (MSME) and other labor intensive sectors, in line with that for exporters in MSME, subject to an increased employment by the unit. This suggests that financial incentives, not only fiscal incentives, can be made conditional to the number of new jobs created.<sup>47</sup>

Table 11 shows that employment-related fiscal incentives are used in other developing countries too. In some cases, employment and training of local employees is included among the eligibility requirements to enjoy fiscal investment incentives, without fixing a quantitative criteria linking the number of jobs created by the investment project to the tax discount. This is the case for instance of Botswana and Rwanda. In other countries, employment-related fiscal incentives are reserved to labor-intensive productive activities by fixing by law a maximum capital-labor ratio for the eligibility to the tax discount. This is the case of Nigeria and the Philippines. Further, structural diversification and employment objectives can be intersected as in the case of Papua New Guinea, where firms producing a product which was never manufactured before in Papua New Guinea or whose import substitution is incomplete are entitled to a subsidy for each full time citizen employee. Finally, fiscal incentives are offered in some countries to stimulate the hiring of specific types of workers, such as women, youth or ethnic minority. This is the case, for instance, in South Africa and in Vietnam.

The examples above illustrate how some developing countries use fiscal incentives to aim at employment objectives, at the same time sometimes aiming at structural diversification and other economic development objectives. The effectiveness of these incentives varies depending on the country-specific situation, their design and implementation, as well as on the existence of other policies supporting both firms' job creation and workers' employability. Rwanda, for instance, terminated with the publication of the new Investment Code 2015 an employment-based tax incentive offering companies profit tax discounts based on the number of Rwandans employed and maintained during a six-month period (from 2% for 100-200 Rwandans employees up to 7% for more than 900 Rwandans employees) as "it did not achieve its strategic goals", as

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<sup>46</sup> Income-tax Act, 1961–2015, Section - 80JJAA.

<sup>47</sup> Information retrieved from <http://indianexpress.com/article/business/business-others/employment-generation-tax-sops-flexi-hiring-key/>

declared by the division manager in charge of investment promotion and facilitation at Rwanda Development Board.<sup>48</sup>

What can be said about in general about employment-based fiscal and financial incentives, is that their optimal design varies with the strategic objective of the instrument. If the policy objective is to generate employment in order to alleviate poverty or correct for a short-run economic downswing, then employment-based incentives can be made more effective by loosening the eligibility requirements, for instance by including in the tax discount more sectors and smaller firms, or granting the benefit for hiring both contractual workers and regular employees.

If the policy objective is to generate employment *and* at the same time promoting a long-run change in the structure of employment towards more productive firms and sectors, then employment-based incentives can be made more effective by supplementing the employment-based eligibility requirements with some structural transformation-based eligibility requirement. The above-mentioned employment-based incentive used in Papua New Guinea for firms producing a product which was never manufactured before in the country or whose import substitution is incomplete, provides an example of how to combine employment and structural transformation objectives in a fiscal incentive. Similarly, employment-based incentives can be offered to firms taking on a loan for technology upgrading, obtaining international quality standards certifications or providing quality-testing and technical analysis services, to technical and professional private schools, to firms employing highly-skilled workers, or to high-tech start-ups founded by foreign-trained citizens returning to their home countries.

## 2.8 Concluding observations

In this paper we have presented a multi-country analysis of fiscal and financial incentives currently in use in several Sub-Saharan African, South Asian and South East Asian developing countries, with the aim of individuating common and innovative practices, as well as expected beneficial outcomes and possible drawbacks of investment incentives regulations directed to structural transformation policy goals, such as industrial diversification, domestic value added augmentation, employment creation and inclusive economic development more generally.

The analysis assumes a basic awareness of the necessity to assess each incentive policy with respect to its short- and long-run costs and benefits, as well as of the risks of corruption and mismanagement associated with the implementation of incentives in general, hence the importance of Rodrik's principles of "embeddedness", "discipline" and "accountability" in the design and management of incentives. The question of implementation is particularly important for low income countries, as many of them have gaps concerning the basic requirements for industrial policy success defined by Rodrik (embeddedness, discipline and accountability).<sup>49</sup>

While being aware of the importance of the question of implementation, this study focuses on the design of investment incentives for structural transformation and job

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<sup>48</sup> The New Times, July 3, 2015. <http://www.newtimes.co.rw/section/article/2015-07-03/190278/> Further investigation would be needed to understand the reasons why this employment-based incentive did not work in Rwanda.

<sup>49</sup> I would like to thank Aurelio Parisotto for providing this comment.

creation. This is mainly due to the nature of this research, based on documentary sources and quite broad in terms of number of countries covered. Examples of successful and unsuccessful implementations of investment incentives policies are best studied for a limited number of countries and supplemented with direct sources such as interviews with key informants, and would therefore go beyond the scope of this research. However, design and implementation are not independent, as investment incentives can be designed in such a way to be best implemented in the context of low income countries, essentially by making targets and conditions easy to measure and to demonstrate, and by being aware of the possible impacts of specific measures on different agents in different contexts. Against this background, this study aims at individuating the expected beneficial outcomes and possible drawbacks of specific incentive tools with respect to specific policy objectives, on different agents and in different stages of development, in order to provide guidance about the design of investment incentives and associated supportive policies in the context of structural transformation and inclusive development strategies.

Many developing countries in different world regions use location-based tax reductions and exemptions – in particular tax holidays offered to foreign-owned large companies based in special economic zones – and sector-based fiscal incentives shaped to attract foreign and domestic “pioneer” investments in priority sectors and production activities that are considered important for the country-specific development strategy.

Several countries are evolving from the use of simple location-based and sector-based fiscal incentives to incentives conditional on the generation of a positive spillover in the economy. As we have seen, countries adopt different criteria to select investments contributing to the country’s structural transformation, from the percentage of locally produced value added, to the use of local inputs (nowadays less and less in use due to the SCM and TRIMS WTO agreements), or the supply of intermediate goods and services to exporters or large manufacturers. The main idea is to exclude from the preferential fiscal treatment pure assembly operations of imported inputs and components, and to favor private investments that contribute to the country’s productive capacity and evolution towards a more sophisticated production structure and longer domestic value chains.

At the same time, we have cautioned against the risk of excluding local firms from the fiscal or financial benefits, when the value added or input supply requirements demanded by the fiscal or financial incentives are too high compared to the local firms’ production and technological capabilities (causing the benefits to attract over-proportionately foreign-invested companies). This risk can be moderated by supporting the development of local firms with government programs for access to credit, technology and human resources, as well as by incentivizing large firms to provide technical assistance, training or financial services to their local suppliers, or to set up outgrower schemes, joint ventures or micro-franchising businesses with local firms.

We have also discussed the necessity to stimulate domestic firms to produce with certified international quality standards. This is crucial for local producers of parts, components and ancillary services to be able to supply large exporting companies, as well as for all domestic firms to be able to compete internationally and export directly. From our analysis it emerges that only few developing countries (particularly in Asia) provide fiscal or financial incentives for firms obtaining or providing international standards conformity certifications. Note that beyond being a crucial link for the participation of domestic firms to international value chains, the promotion of certified international quality standards would generate employment opportunities in related sectors such as quality testing and calibration laboratories, or consulting and certification services. However, in order to maximize the impact on local employment, these policy



measures should be accompanied by appropriate education and training programs for laboratory technicians and analysts.

With regard to the development of SMEs more generally, our analysis of fiscal and financial incentives has highlighted the necessity to differentiate more systematically the design of fiscal and financial incentives in favor of SMEs: CIT rates, minimum investment thresholds, depreciation rates, as well as expenditure deduction allowances can be reduced (or enhanced) for SMEs with respect to the values set for larger firms.

Having said that, the incentives used to promote SMEs start-ups and development can be adjusted depending on the policy objectives and the stage of development. In low and lower-middle income countries – where the main policy objectives in regard to SMEs include joining SMEs into the tax system and creating employment opportunities, incentives can focus on offering reduced CIT rates for SMEs, as well as temporary exemptions from income tax or government financial grants to SMEs start-ups engaged in labor-intensive sectors.

In lower- and upper-middle income countries – where the policy objectives in regard to SMEs gradually shift from formalization and employment generation to the enhancement of SMEs technological and productive capabilities, and the creation of productive employment for skilled workers – fiscal incentives for SMEs can be made conditional to technology- and quality-related requirements (such as international quality-certifications or the employment of high-skilled workers) and financial incentives can focus on promoting bank loans to SMEs (such as with loan guarantees and targeted refinancing lines). In this context, however, it is important not to rely on bank loans only, as many small firms at this stages of development are still unable to take bank loans (due to the lack of real estate collaterals and account books, or to unsecure financial situations) and therefore need financial, educational and regulatory support from the government to grow into more advanced businesses.

In an analogous manner, employment-based investment incentives can be adjusted depending the strategic objective of the instrument. If the policy objective is to generate employment in order to alleviate poverty or correct for a short-run economic downswing, then employment-based investment incentives can be made more effective by loosening the eligibility requirements, for instance by granting the benefit to investors hiring both contractual workers and regular employees. If the policy objective is to generate employment and at the same time promoting a long-run change in the structure of employment towards more productive firms and sectors, then employment-based investment incentives can be made more effective by tightening the eligibility requirements, for instance by granting the hiring benefit to investors obtaining international quality standards certifications, or to high-tech start-ups founded by foreign-trained citizens returning to their home countries.

More generally, in order to promote structural transformation as well as inclusive, job-rich and sustainable development, fiscal and financial investment incentives should be multi-dimensional. By multi-dimensional investment incentives we mean that the tax discounts, tax deductions or financial incentives set up to promote private investments in specific industrial sectors, value-adding production activities or desirable capital expenditures, should be further differentiated depending on the firm size (with preferential treatment for SMEs), on the age, sex, or skill level of the entrepreneur or of the employees (with preferential treatment for youth, women and, in the case of middle-income countries, highly skilled workers especially if returning to their home countries), the quality of production (with preferential treatment for products with international quality certifications) as well as on the sustainability and social impact of the investment (with preferential treatment for activities protecting the environment, promoting the

valorization of the local natural endowments, craftsmanship, culture and traditions, and creating local employment opportunities).

In this sense, the design of “development-oriented” fiscal and financial incentives requires the awareness of all stakeholders involved in the process of structural transformation and inclusive and sustainable development, from the ministries of industries, trade, and finance & development to the ministries of labour, education & research, and the environment as well as the central bank and the private sector. Not much documented evidence is available about the process through which investment incentives are actually designed, and further research would be needed to gather examples of strategic collaborations between government, central and development banks and private sector in designing investment incentives for structural transformation and inclusive development. In particular, the role of business associations seems quite relevant in the design of investment incentives, as they can both provide insights about investment opportunities and bottlenecks (Rodrik, 2010) and can gather business general interest beyond specific firm and mitigate opportunism through peer pressure<sup>50</sup>

Last but not least, we would like to emphasize that investment policy is just one ingredient of the structural transformation and development policy mix. The development of a country’s technical, managerial, innovative and cultural capabilities entails an integrated approach of different policies ranging from investment policy (including incentives, regulatory and institutional aspects), to technology and innovation policy, employment policy, education and training policy, rural and urban policies and more.

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<sup>50</sup> I would like to thank Aurelio Parisotto for providing this comment.

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**Table 3. Examples of fiscal incentives for higher-value added production in sub-Saharan Africa and Asian developing countries**

Region / Country	Beneficiary sectors / firms / activities	Fiscal incentives (CIT reductions and exemptions)
<b>Sub-Saharan Africa</b>		
Botswana	Companies engaged in manufacturing, defined as “processing of raw materials that result in the product having a <b>new and distinctive characteristics</b> from the raw material from which it is made”.	Reduced CIT rate (15% instead of 22%)
Cameroon, Republic of	Incentives common to all sectors must meet one of the four following conditions: (1) Employ during the operational phase at least one Cameroonian for projected investments ranging from 5 to 25 million francs CFS; (2) Carry out annual export activity ranging from 1 to 25% of sales excluding taxes; (3) Use national resources to the extent of 10 to 25% of the value of inputs; (4) <b>Contribute to value added to the turnover</b> revenue of 10 to 30% of turnover excluding taxes. Note: investors can benefit from tax credit provided they hire at least five graduates of higher education per years; fight against pollution; promote sporting, cultural or social activities; promote public interest activities in rural areas	During the installation phase (5 years) and the operational phase (max 10 years) exemptions from or reductions of several taxes, duties and other fees listed
Congo, Democratic Republic of	In order to take advantage of the provision of the Investments Code, the following conditions must be fulfilled by the investor: (1) The investor must be a Congolese legal entity; (2) The investment must be at least USD 200'000; (3) The investing company must comply with the rules and regulations relating to environment; (4) The investing company must undertake to train local personnel in technical and executive duties; (5) The investing company must undertake <b>to create an added value of 35% of its initial investment</b> (within a stipulated time period to be agreed).	CIT exemption (different time periods depending on location)
Ivory Coast	In order to benefit from fiscal advantages, investors engaged in specified priority sectors must apply to the Centre de Promotion des Investiments en Côte d'Ivoire. Applications are approved “based on the <b>value added</b> created in Ivory Coast and the economic and social development objectives”,	CIT exemption (5, 8 or 15 years depending on location)
<b>Asia</b>		
Malaysia	Manufacturing companies are eligible for an income tax exemption of 10% (or 15%) of the value of the increased exports provided the goods exported attain at least 30% (or 50%) of <b>value added</b> (for SMEs 20% or 40% of value added respectively)	
Sri Lanka	Manufacturing companies producing any product with a <b>minimum of 35% value addition</b> if more than 50% of the production is to be sold in the domestic market  Manufacturing companies producing any product for export or for supply to an exporter for export, being a product having <b>domestic value addition over 65%</b> and a Sri Lanka brand name with patent rights received in Sri Lanka	Reduced CIT rate (10% instead of 28%)
Thailand	In order to benefit from fiscal advantages investors must receive an approval from the Board of Investment. One of the criteria used by BOI for the approval is: “The <b>value added must be a t least 20%</b> of sales revenue (except for electronic products, agricultural produce, and coil centers, all of which must have value added of not less than 10% of revenue.)	Various fiscal incentives granted to BOI approved investors

Sources (see next page)

Sources: Botswana: Manufacturing Development Approval Order (1<sup>st</sup> July, 1995) subsidiary legislation to the Income Tax Act. <http://www.taxrus2000.com/pdf/English-DTA-Botswana-Rusia.pdf>  
Cameroon, Rep.: Law No. 2013/004 of 18 April 2013. <http://investincameroon.net/en/investment-incentives/incentives-for-private-investment.htm>  
Congo, Dem. Rep.: ANAPI National Agency for Promotion of Investments. <http://www.investindrc.cd/en/spip.php?article682>  
Ivory Coast: Investment Code 2012, Art. 39. <https://cepici.ci/en/web/docs/code-des-investissements.pdf>  
Malaysia: P.U.(A) 128 – Income Tax (Allowance for Increased Exports) Rules 1999 as amended by P.U.(A) 309 – Income Tax (Allowance for Increased Exports) (Amendments) Rules 2003. [http://www.accaglobal.com/content/dam/acca/global/pdf/sa\\_may11\\_p6mys\\_incentives.pdf](http://www.accaglobal.com/content/dam/acca/global/pdf/sa_may11_p6mys_incentives.pdf)  
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Thailand: ASEAN Briefing. <http://www.aseanbriefing.com/news/2015/08/19/trailands-new-investment-promotion-policies-open-a-new-door-to-foregin-investors.html>

**Table 4A. Fiscal Incentives for Local Supply Chain Development – sub-Saharan African developing countries**

Country	Beneficiary sectors / firms / activities	Fiscal incentives (CIT reductions and exemptions)	Requirements for fiscal incentives		
			Use of local inputs	Supply of local inputs	Development of local suppliers
Cameroon, Republic of	Incentives common to all sectors must meet one of the four following conditions: (1) Employ during the operational phase at least one Cameroonian for projected investments ranging from 5 to 25 million francs CFA; (2) Carry out annual export activity ranging from 10 to 25% of sales excluding taxes; (3) <b>Use national resources to the extent of 10 to 25% of the value of inputs</b> ; (4) Contribute to value added to the tune of 10 to 30% of turnover revenue excluding taxes. Note: Investors can benefit from tax credit provided they hire at least five graduates of higher education per year; fight against pollution; promote sporting, cultural or social activities; promote public interest activities in rural areas.	During the installation phase (5 years) and the operational phase (max 10 years) exemptions from or reductions of several taxes, duties and other fees listed	X		
Ethiopia	Investors who export at least 60% or <b>supply at least 60% of their products or services to an exporter.</b>	Additional 2 years of CIT exemption (after initial 1 to 9 years, depending on sector and location)		X	
Ghana	Companies engaged in the export of “non-traditional products”, defined as “horticultural products; <b>processed and raw agricultural products grown in Ghana</b> other than cocoa beans; wood products other than lumber and logs; handcrafts; <b>and locally-manufactured goods.</b> ”	Reduced CIT rate (8% instead of 25%)	X		
	Agro-processing companies, which use <b>Ghana’s agricultural raw materials as their main inputs</b> , and cocoa by-products companies	Reduced CIT rate (0%-20% depending on the location, after an initial tax holiday)	X		
Nigeria	Industries that attain minimum local raw materials sourcing and utilisation as follows: Agro-allied 70%, Engineering 60%, Chemicals 60%, Petrochemicals 70%.	Tax credit of 20% for 5 years	X		
	Profits of companies whose supplies are exclusively <b>inputs to the manufacture of products for export</b> are exempt from tax. Such companies are expected to obtain a certificate of purchase of the input from the exporter in order to claim tax exemption.	CIT exemption (for how many years?)		X	

Sources: Cameroon, Rep: Law No. 2013/004 of 18 April 2013. <http://investincameroon.net/en/investment-incentives/incentives-for-private-investment.htm>  
 Ethiopia: Ethiopian Investment Commission (EIC). <http://investethiopia.gov.et/images/pdf/incentives.pdf>  
 Ghana: Ghana Investment Promotion Centre (GIPC). <http://www.gipcghana.com/invest-in-ghana/why-ghana/tax-regime-and-incentives.html>  
 Nigeria: Nigeria Investment Act. <http://nipc.gov.ng/index.php/invest-in-nigeria/investment-incentives.html>, and <http://www.nipc.gov.ng/index.php/invest-in-nigeria/investment-incentives.html>



**Table 4b. Fiscal Incentives for Local Supply Chain Development – Asian developing countries**

Country	Beneficiary sectors/firms/activities	Fiscal incentives (CIT reductions and exemptions)	Requirements for fiscal incentives		
			Use of local Inputs	Supply of Local inputs	Development of local suppliers
Bangladesh	"With the intention of encouraging backward linkages, export-oriented industries including export-oriented ready-made garment industries <b>using indigenous raw materials instead of imported materials</b> , are given additional facilities and benefits at prescribed rates. <b>Similar incentives are extended to the suppliers of raw materials</b> to export-oriented industries."	n.a.	X	X	
Cambodia	Supporting industries, supplying the entire production (100%) to an export industry. Minimum investment required: US\$100,000.	Various fiscal incentives granted to Qualified Investment Projects (QIPs)		X	
Papua New Guinea	Extension services provided free of charge to smallholder growers, including the provision of advice, training, and technical assistance in relation to primary production to assist growers with production, processing, packaging, and marketing issues.	150% expenditure deduction from taxable income			X
Philippines	"In order to benefit from fiscal advantages, companies engaged in specified priority activities must register with the Board of Investment. BOI-registered companies enjoy one extra year of CIT exemption in some specified cases including the following: • The indigenous raw materials used in the manufacture of the registered product is at least 50% of the total cost of raw materials."	Additional 1 year of CIT exemption (after initial 3 to 6 years, depending on project and location)	X		
Sri Lanka	Software developed in Sri Lanka	100% expenditure deduction from taxable income	X		
	Joint venture between a grower-manufacturer or a manufacturer of tea with a tea exporter for exporting Sri Lanka tea in value added form, on the manufacturing income attributable to the quantum of tea purchased.	Reduced CIT rate (12% instead of 28%)			X
Thailand	Intellectual property acquisition/licensing fees for commercializing technology developed in Thailand	100% expenditure deduction from taxable income	X		
	Development of local suppliers with not less than 51% Thai shareholding in advance technology training or technical assistance	100% expenditure deduction from taxable income			X

Country	Beneficiary sectors/firms/activities	Fiscal incentives (CIT reductions and exemptions)	Requirements for fiscal incentives		
			Use of local Inputs	Supply of Local inputs	Development of local suppliers
Vietnam	<p>"From 2015, new investment projects in ""supporting industries"" included in the government list of prioritised industrial products (issued 30 December 2015) are eligible for tax incentives. In order to qualify for these incentives, the products must support:</p> <ul style="list-style-type: none"> <li>• the high technology sector, or</li> <li>• the garment, textile, and footwear; information technology (IT); automobile assembly; or mechanical sector and are not produced domestically as of 1 January 2015, or, if produced domestically, they meet the quality standards of the European Union (EU) or equivalent."</li> </ul>			X	

Source: Bangladesh: Dhaka Chamber of Commerce and Industry. [http://www.dhakachamber.com/home/investment\\_additional\\_incentives](http://www.dhakachamber.com/home/investment_additional_incentives)  
Cambodia: Sub-Decree No. 111, Annex 1, Section 2. <http://www.cambodiainvestment.gov.kh/investment-scheme/investment-incentives.html>  
Papua New Guinea: PwC (2015), Worldwide Tax Summaries. Corporate Taxes 2015/16, p. 1574  
Philippines: PwC (2015), Investment Incentives in the Philippines, p. 7. <http://www.pwc.com/ph/en/business-guides/assets/documents/pwc-investment-incentives-in-the-philippines-2015.pdf>  
Sri Lanka: Inland Revenue Act, No. 10 of 2006 (incorporating amendments up to 2014) as published by the Department of Inland Revenue (section 16.C p. 40 and section 59.A p. 123  
PwC (2015), Worldwide Tax Summaries. Corporate Taxes 2015/16, p. 1951  
Thailand: PwC (2015), Worldwide Tax Summaries, Corporate Taxes 2015/16, p. 2031  
Vietnam: Government of Vietnam, Decree No. 111

**Table 5. Fiscal and financial incentives for the promotion of quality-certified production – Asian developing countries**

Country	Beneficiary sectors / firms / activities	Fiscal / financial incentives
India	Permanent Registered Micro Small Enterprises (MSEs) units are eligible to avail a financial incentive scheme for their technological upgradation/quality improvement and environment management, upon the <b>achievement of ISO-9000/ISO-14001/HACCP certifications.</b>	Reimbursement of 75% of the expenditure subject to a maximum of Rs. 75,000 for each certificate.
	Expenditure incurred for the purposes of obtaining recognized quality systems and standards and halal certification.	200% expenditure deduction from taxable income
Malaysia	Some export-promotion expenditures qualify for double tax deduction provided that products are of "export-quality standard", defined as the products being already exported or, if not yet exported, having acquired international quality certification.	200% expenditure deduction from taxable income
	Tax incentives for the establishment of "Independent Conformity Assessment Bodies" (ICAB), defined as companies "providing conformity assessment services by testing products, materials, systems or services for conformance to international specifications or safety standards and other conformities."	Information not found
Thailand	In order to benefit from fiscal advantages investors must receive an approval from the Board of Investment. One of the criteria used by BOI for the approval is: "A project with THB 10 million of capital investment must obtain a certification, such as ISO 9000, ISO 14000, or similar international standard certification within two years from the full operation start-up date, otherwise the CIT exemption will be reduced by one year."	Various fiscal incentives granted to BOI-approved investors
Vietnam	"From 2015, new investment projects in ""supporting industries"" included in the government list of prioritised industrial products (issued 30 December 2015) are eligible for tax incentives. In order to qualify for these incentives, the products must support: <ul style="list-style-type: none"> <li>the high technology sector, or</li> <li>the garment, textile, and footwear; information technology (IT); automobile assembly; or mechanical sector and are not produced domestically as of 1 January 2015, or, if produced domestically, they meet the quality standards of the European Union (EU) or equivalent."</li> </ul>	Reduced CIT rate (10% for 15 years, instead of 20%), with 4 years CIT exemption and 9 years 50% CIT reduction

Sources: India: Ministry of micro, small and medium enterprises. <http://www.dcmsme.gov.in/schemes/sciso9000.htm>  
Malaysia: Subparagraph 34(6)(ma) Income Tax Act 1967 (updated July 2011) [http://www.ctim.org.my/file/news/14/01467\\_IRB%20-%20Updated%20List%20of%20Certification%20Bodies%20Under%20S34\(6\)\(ma\)%20of%20ITA%20\(110711\).pdf](http://www.ctim.org.my/file/news/14/01467_IRB%20-%20Updated%20List%20of%20Certification%20Bodies%20Under%20S34(6)(ma)%20of%20ITA%20(110711).pdf)  
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Vietnam: Government of Vietnam, Decree No. 111/2015/ND-CP issued 3 November 2015; and Ministry of Industry and Trade, Circular No. 55/2015/TT-BCT issued on 30 December. <https://home.kpmg.com/xx/en/home/insights/2016/01/tmf-vietnam-tax-incentives-certain-products-of-supporting-industries.htm>

**Table 6. Summary of incentives for domestic value addition, local supply chain, and domestic technology development**

Objectives	Fiscal incentives offered	Beneficial expected outcomes	Drawbacks	Possible improvements / Additional policies
Domestic value addition / domestic technology development	Reductions in income tax based on local value added creation	Encourages manufacturing and other value-adding productive activities /discourages pure assembly operations of imported inputs and components	Excludes from the preferential fiscal treatment lower-value added activities (i.e. ancillary industries and services) where local firms are typically concentrated.	Lower local value-added thresholds for SMEs eligibility
Local supply chain development / domestic technology development / quality-certified production	Reductions/deductions in income tax based on use of local inputs	Encourages the use of local inputs	Non-compliant with WTO regulations	Deductions better than reductions in income tax (?)
	Reductions in income tax based on supply of local inputs	Encourages the development of “supporting industries” and local value chain deepening	Local firms may not have capability to supply large manufacturers, hence incentives may over-attract foreign firms into domestic supporting industries	Support local manufacturers of intermediate goods and services with policies for access to credit, technology and human resources development
	Deductions in income tax based on expenditure for development of local suppliers	Encourages large manufacturers to provide training and technical assistance to their suppliers		Tax benefits for outgrower schemes, joint-ventures and (micro-)franchising to promote knowledge transfer
	Reductions/deductions in income tax based on international quality-certified production	Encourages local firms to achieve international quality standards certifications Encourages creation of new companies and jobs in quality testing laboratories and related services		<i>Financial</i> incentives to support firms obtaining international quality standards certifications Fiscal and financial incentives to set up new companies providing quality testing and related services

**Table 7a. Tax rules specific to SMEs, Sub-Saharan African developing countries**

Country	Tax rules specific to SMEs	SMEs Corporate Income Tax	
		Presumptive taxation (turnover tax)	Reduced CIT rate for SMEs
Ethiopia	Business income from body corporates is taxed at a flat rate of 30%. Business income of individuals is taxed at progressive rates 0%-35%. Most SMEs are actually taxed under "presumptive taxation" with 10%-30% margin.	X	
Ghana	The Income Tax Act 2015 introduced "presumptive taxation" at 6% of turnover for businesses and business income of individuals whose turnover falls below GH¢200,000 .	X	
Nigeria	Small companies with turnover not exceeding 1 million Nigerian naira (US\$ 6450) enjoy reduced CIT rate of 20% (instead of 30%).		X
	The Nigerian Government through the Federal Inland Revenue Service is developing a presumptive tax regime. As of May 2016 the regulation is not yet operational.	X	
Rwanda	Small businesses and individuals whose business has a turnover of less than 20 million Rwanda francs in a tax period pay a presumptive tax of 4% of turnover (but can opt for the real regime based on taxable profit).	X	
South Africa	Small business corporations (i.e. companies with only natural persons as members/owners and with gross income of not more than ZAR 20 million) pay 0% on the first ZAR 73,650 of taxable income earned, 7% on the amount above ZAR 73,650 but not exceeding ZAR 365,000, 21% on the amount above ZAR 365,000 but not exceeding ZAR 550,000, and 28% on the amount exceeding ZAR 550,000.		X
	Very small companies (with a turnover of less than ZAR 1 million per year) pay a presumptive tax of 0%-3% of turnover.	X	

Source: Ethiopia: Council of Ministers Regulations N.84/2003 Regulations on Investment Incentives. <http://www.ethiopianchamber.com/Data/Sites/1/downloadables/INVESTMENT%20%20CODE/INVESTMENT%20%20REGULATIONS%20NUMBER%2084-1995.pdf>  
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Rwanda: Annex to Law N. 06/2015 of 28/03/2015 on Investment Promotion and Facilitation. [http://www.rdb.rw/uploads/tx\\_sbdownloader/Investment\\_promotion\\_law.pdf](http://www.rdb.rw/uploads/tx_sbdownloader/Investment_promotion_law.pdf)  
South Africa: PwC (2015), Worldwide Tax Summaries. Corporate Taxes 2015/16, p. 1875.

**Table 7b. Tax rules specific to SMEs, South-Asian and South-East Asian developing countries**

Country	Tax rules specific to SMEs	SMEs Corporate Income Tax	
		Presumptive taxation (turnover tax)	Reduced CIT rate for SMEs
Bangladesh	Income derived from any Small and Medium Enterprise (SME) engaged in production of any goods and having an annual turnover of not more than BDT 3 million is exempt from income tax.		X
Indonesia	Small enterprises (i.e. corporate taxpayers with an annual turnover of not more than IDR 50 billion) are entitled to a 50% tax discount of the standard rate, which is imposed proportionally on taxable income on the part of gross turnover up to IDR 4.8 billion.		X
	Certain enterprises with gross turnover of not more than IDR 4.8 billion are subject to final income tax at 1% of turnover.	X	
Malaysia	"Small companies with chargeable income of less than MYR 500,000 are entitled to a reduced CIT rate of 20% (19% as of 2016) instead of standard rate 25%. Small firms defined as resident companies: <ul style="list-style-type: none"> <li>with paid-up capital of 2.5 million Malaysian ringgit (MYR) or less</li> <li>that does not control, directly or indirectly, another company that has paid-up capital of more than MYR 2.5 million, and</li> <li>is not controlled, directly or indirectly, by another company that has paid-up capital of more than MYR 2.5 million."</li> </ul>		X
Pakistan	Small companies with annual turnover not exceeding PKR 250 million are entitled to a reduced CIT rate of 25% (instead of standard rate 33%).		X
Papua New Guinea	PNG government's SME Policy Development (launched in March 2016) will include implementation of tax rules and incentives specific to SMEs, with specific proposals for a 5 year start up tax holiday for micro and small businesses, reduced tax rate for SMEs, and tax credits for large companies who provide patronship, mentoring or business development services to grow SMEs.		X
Philippines	Registered Barangay Micro Business Enterprises (BMBEs) are exempt from income tax. BMBEs defined as any business enterprise engaged in production, processing, or manufacturing of products, including agro-processing, as well as trading and services, with total assets of not more than P3 million.		X
Sri Lanka	Small and medium enterprises engaged in the manufacture of any article or provision of any services, subject to the turnover of such company not exceeding LKR 750 million, are entitled to a reduced CIT rate of 12% (as of 1 June 2015) instead of standard rate 28% (threshold increased from 500 to 750 million LKR as of 2015/16).		X
Thailand	Companies with a paid-in capital not exceeding 5 million Thai baht (THB) and income from the sale of goods and/ or the provision of services not exceeding THB 30 million in any accounting period are entitled to the following reduced CIT rates depending on the company's net profits: 0% (0 to 300,000 THB net profits); 15% (300,001 to 3 million THB). Standard CIT rate is 20%.		X
Vietnam	Small and medium enterprises with total revenue of less than 20 billion Vietnamese dong (VND) or fewer than 200 employees (since 2009) are entitled to a reduced CIT rate of 20% (instead of standard rate 22%).		X

Sources: see next page

### Table 7b. Tax rules specific to SMEs, South-Asian and South-East Asian developing countries

Sources:	Bangladesh:	National Board of Revenue (2015) Income Tax at a Glance. <a href="http://www.nbr.gov.bd/contents/publication/107.pdf">http://www.nbr.gov.bd/contents/publication/107.pdf</a>
	Indonesia:	PwC (2015), Worldwide Tax Summaries. Corporate Taxes 2015/16, p. 900.
	Malaysia:	PwC (2015), Worldwide Tax Summaries. Corporate Taxes 2015/16, p. 1285.
	Pakistan:	PwC (2015), Worldwide Tax Summaries. Corporate Taxes 2015/16, p. 1546.
	Papua New Guinea:	PwC (2016), Overview and commentary on the PNG Government's SME Policy. <a href="https://www.pwc.com/pg/en/publications/sme-bulletin/sme-bulletin-png-sme-policy-commentary.pdf">https://www.pwc.com/pg/en/publications/sme-bulletin/sme-bulletin-png-sme-policy-commentary.pdf</a>
	Philippines:	Congress of the Philippines (2002) R.A. 9178: Barangay Micro Business Enterprises (BMBEs) Act. <a href="http://www.businessesfightingcorruption.org/laws/RA_9178.pdf">http://www.businessesfightingcorruption.org/laws/RA_9178.pdf</a>
	Sri Lanka:	PwC (2015), Worldwide Tax Summaries. Corporate Taxes 2015/16, p. 1942.
	Thailand:	PwC (2015), Worldwide Tax Summaries. Corporate Taxes 2015/16, p. 2022 and 2029.
	Vietnam:	PwC (2015), Worldwide Tax Summaries. Corporate Taxes 2015/16, p. 2254.

**Table 8. Fiscal incentives rules for Small and Medium Enterprises (SMEs) in selected Sub-Saharan and Asian developing countries**

Country	Tax rules and incentives specific to SMEs	SMEs inclusion in fiscal incentives laws			SMEs specific expenditure based incentives	Incentives for large firms supporting SMEs
		High minimum investment required	No minimum investment required	SMEs specific lower thresholds		
<b>Sub-Saharan Africa</b>						
Botswana	<b>No minimum investment included in the requirements</b> to access investment incentives: all companies can apply for a Development Approval Order (DAO) to the Minister of Finance and Development Planning. To release a DAO the Minister must be satisfied that the proposed project will be beneficial to Botswana's economy.		X			
Cameroon, Republic of	<b>No minimum investment included in the requirements</b> to access investment incentives. The process to qualify for the benefits of the investment law requires three different approvals: the one-stop shop body, the Minister of Finance and the Minister of Private Investment.		X			
Congo, Dem. Rep.	<b>The requirements to access the benefits of the Investment Code are differentiated by firm size</b> (total cost of the planned investment must be at least \$200,000, or at least \$10,000 for SMEs). Applications must be approved by the National Agency for the Promotion of Investments (ANAPI).			X		
Ivory Coast	<b>The requirements to access the benefits of the Investment Code are differentiated by firm size</b> (lower investment thresholds for SMEs). The Investment Code includes various tax reductions and exemptions (available to both large and small companies, but SMEs enjoy them for longer time periods) and additional benefits specific to SMEs, such as lower electricity and water tariffs.			X	X	
Nigeria	<b>Minimum investment thresholds</b> to qualify for tax holiday in eligible industries are differentiated between foreign-owned and local companies (for joint ventures and wholly foreign-owned companies at least N5million and indigenous companies at least N150,000).			X (?)		
Rwanda	<b>Minimum investment included in the requirements</b> to access the benefits of the Investment Promotion Law (at least US\$ 10 millions for 0% CIT rate, and US\$ 50 millions for up to 7 years tax holiday).	X				
Senegal	To be eligible to the Investment Code, planned investment must be at least XOF100 million (circa US\$170,000). However, <b>for small and medium-sized companies</b> involved in primary sector, health and education, and some services, <b>the minimum investment required</b> is XOF15 million (circa US\$25,000).			X		



Country	Tax rules and incentives specific to SMEs	SMEs inclusion in fiscal incentives laws			SMEs specific expenditure based incentives	Incentives for large firms supporting SMEs
		High minimum investment required	No minimum investment required	SMEs specific lower thresholds		
South Africa	With regard to <b>depreciation of plant and machinery</b> , small business corporations are allowed a 100% capital allowance for manufacturing assets, and 50%/30%/20% depreciation rates for other depreciable assets.				X	
<b>Asia</b>						
Malaysia	The 2016 budget, presented 23 October 2015, proposes an automatic " <b>double deduction</b> " with respect to research and development ( <b>R&amp;D projects</b> ) undertaken by SMEs. The proposal is effective from 2016 to 2018.				X	
	"To encourage SMEs to expand their export markets, the 2016 budget proposes the following revised value added criteria for SMEs to enjoy the "increased export allowance" currently offered to all manufacturing companies: <ul style="list-style-type: none"> <li>Income tax exemption of 10% of the value of the increased exports provided that the goods exported attain at least 20% value added (reduced from the current 30%);</li> <li>Income tax exemption of 15% of the value of increased exports provided that the goods exported attain at least 40% value added (reduced from the current 50%).</li> <li>The above income tax exemption is restricted to 70% of the statutory income. The proposal is effective from YA 2016 to YA 2018"</li> </ul>			X		
Papua New Guinea	PNG government's SME Policy Development (launched in March 2016) will include implementation of tax rules and incentives specific to SMEs, with specific proposals for a 5 year start up tax holiday for micro and small businesses, reduced tax rate for SMEs and tax credits for large companies who provide patronship, mentoring or business development services to grow SMEs.			X		X
Thailand	"Companies and juristic partnerships with fixed assets, excluding land, with a value of no more than THB 200 million and with no more than 200 employees are entitled to the following special depreciation rates: <ul style="list-style-type: none"> <li>Machinery and equipment may initially be depreciated at 40% of cost, and the remaining balance will then be depreciated at the maximum rate of 20%.</li> <li>Computer hardware and software may initially be depreciated at 40% of cost, and the remaining balance can then be depreciated within three accounting periods.</li> <li>Factory buildings may initially be depreciated at 25% of cost, and the remaining balance will then be depreciated at the maximum rate of 5%."</li> </ul>				X	

**Table 8. Fiscal incentives rules for Small and Medium Enterprises (SMEs) in selected Sub-Saharan and Asian developing countries**

Sources:	Botswana:	Manufacturing Development Approval Order (1st July, 1995), 52(1), subsidiary legislation to the Income Tax Act. <a href="http://www.taxrus2000.com/pdf/English-DTA-Botswana-Russia.pdf">http://www.taxrus2000.com/pdf/English-DTA-Botswana-Russia.pdf</a> Income Tax Act, 1973 as amended. Vol. 12, Ch. 52:01 Provisions relating to companies and partnerships. <a href="http://www.elaws.gov.bw/rtf_pr_export.php?id=2282">www.elaws.gov.bw/rtf_pr_export.php?id=2282</a> PwC (2015), <i>Worldwide Tax Summaries</i> . Corporate Taxes 2015/16, p. 265.
	Cameroon, Republic of:	Law No. 2013/004 of 18 April 2013. <a href="http://investincameroon.net/en/investment-incentives/incentives-for-private-investment.html">http://investincameroon.net/en/investment-incentives/incentives-for-private-investment.html</a> Code General des Impots du Cameroun, 2015. <a href="http://www.investir-afrique.com/doc_2015/code_general_des_impots_du_cameroun_2015.pdf">http://www.investir-afrique.com/doc_2015/code_general_des_impots_du_cameroun_2015.pdf</a> (the General Code of Taxes 2015 does not include any reduced CIT rate for SMEs).
	Congo, D.R.:	Law N. 004/2002 of 21 February 2002 on the Investment Code. <a href="http://investindrc.cd/fr/IMG/pdf/investment_code.pdf">http://investindrc.cd/fr/IMG/pdf/investment_code.pdf</a>
	Ivory Coast:	Republique de Côte d'Ivoire (2012) Code des Investissements, Titre V: Dispositions spécifiques aux petites et moyennes entreprises. <a href="http://www.cepici.gouv.ci/?tmp=image-top&amp;p=code-des-investissements">http://www.cepici.gouv.ci/?tmp=image-top&amp;p=code-des-investissements</a>
	Nigeria:	Nigeria Investment Promotion Commission. <a href="http://www.nipc.gov.ng/index.php/invest-in-nigeria/investment-incentives.html">http://www.nipc.gov.ng/index.php/invest-in-nigeria/investment-incentives.html</a>
	Rwanda:	Annex to Law N. 06/2015 of 28/03/2015 on Investment Promotion and Facilitation. : <a href="http://www.rdb.rw/uploads/tx_sbdownloader/Investment_promotion_law.pdf">http://www.rdb.rw/uploads/tx_sbdownloader/Investment_promotion_law.pdf</a>
	Senegal:	Code des Investissement 2004. <a href="http://www.embajadasenegal.com/wp-content/uploads/Code-des-Investissements.pdf">http://www.embajadasenegal.com/wp-content/uploads/Code-des-Investissements.pdf</a>
	South Africa:	KPMG 2014/2015 Tax Guide, p.19. <a href="https://www.kpmg.com/ZA/en/IssuesAndInsights/ArticlesPublications/Tax-and-Legal-Publications/Documents/2014%20Tax%20Guide%20final%20lowres.pdf">https://www.kpmg.com/ZA/en/IssuesAndInsights/ArticlesPublications/Tax-and-Legal-Publications/Documents/2014%20Tax%20Guide%20final%20lowres.pdf</a>
	Malaysia:	PwC (2015), <i>Worldwide Tax Summaries</i> . Corporate Taxes 2015/16, p. 1285. KPMG (2015), <i>Malaysia Budget Highlights 2016</i> . <a href="http://www.kpmg.com/MY/en/Documents/TaxHighlights/Budget%202016/Budget-Highlight%202016.pdf">http://www.kpmg.com/MY/en/Documents/TaxHighlights/Budget%202016/Budget-Highlight%202016.pdf</a>
	Papua New Guinea:	PwC (2016), <i>Overview and commentary on the PNG Government's SME Policy</i> . <a href="https://www.pwc.com/pg/en/publications/sme-bulletin/sme-bulletin-png-sme-policy-commentary.pdf">https://www.pwc.com/pg/en/publications/sme-bulletin/sme-bulletin-png-sme-policy-commentary.pdf</a>
	Thailand:	PwC (2015), <i>Worldwide Tax Summaries</i> . Corporate Taxes 2015/16, p. 2029.

**Table 9. Fiscal incentives for SMEs development and technology & quality upgrading**

Objectives	Fiscal incentives	Beneficial expected outcome	Drawbacks	Possible improvements / additional policies
SMEs inclusion in tax system / Employment generation	Reduced standard CIT rate / turnover tax for SMEs	Reduces tax burden for SMEs Can encourage SMEs to comply with tax regulations	Only available to SMEs in tax net	Differentiating income tax rates for micro, small and medium enterprises; simplifying tax system for SMEs
Employment generation / SMEs development / SMEs technology and quality upgrading	Temporary exemptions from income tax for start-ups in priority sectors: <b>lower investment thresholds for SMEs</b>	Encourages SMEs start-ups and creates employment opportunities in priority sectors	Projects may not be resilient in long-run once fiscal benefit is over	Supporting SMEs with financial and entrepreneurial education, access to credit, access to infrastructures and technology, international trade fairs, etc. Including requirements/additional benefits based on value added, international quality-certification, highly-skilled professionals returning to their own country, etc.
SMEs development / SMEs technology and quality upgrading	Deductions in income tax based on targeted expenditures: <b>enhanced rates for SMEs</b>	Encourages SMEs expenditures in advanced technology, training, international quality certifications, R&D, participation to international fairs etc.		Increasing rates above 100% for: smaller enterprises, SMEs with international quality certifications, green technologies, hiring highly-skilled workers or other specific requirements
	Accelerated depreciation: <b>enhanced rates for SMEs</b>	Encourages SMEs investment in capital assets		Same as above.
	Reductions/deductions in income tax for <b>large firms supporting SMEs development</b>	Encourages large firms to provide business development services, training, or financial support to their suppliers		

**Table 10. Financial incentives for SMEs access to financing for start-ups, development and technology & quality upgradation**

Objectives	Financial incentives	Advantages	Disadvantages	Possible improvements / additional policies
SMEs <b>access to financing</b> for start-ups, development and technology and quality upgradation	Grants and concessional loans from government development agencies for SMEs start-ups	Government can select projects according to policy objective (including employment creation)	Projects may not be resilient in long-run once financial help is over	Supporting SMEs with financial and entrepreneurial education, access to infrastructures and technology, international quality certifications, trade fairs, etc.  Including requirements/additional benefits based on international quality-certification, highly-skilled professionals returning to their own country, etc.
			Risk of middlemen	Matching grants (public grants in partnership with private philanthropy foundations or social impact investors)  Simplifying application procedure; creation of dedicated desk for women and youth
	Initial capital grants and interest rate reimbursements on bank loans for targeted expenditures	Alleviates financial burden of bank loans taken on by SMEs for targeted expenditures (such as technology upgrading)	Firms in the “missing middle” excluded from bank loans	Government leasing schemes for SMEs technology upgrading
	Loan guarantees schemes	Encourages commercial banks to provide loans to SMEs and to ask for lower interest rates (lower risk)	Banks may still be reluctant to lend to SMEs	Offering higher percentage of guaranteed loan for SMEs
		Default risk is shifted (partially) to the government	Firms in the “missing middle” excluded from bank loans	Financial literacy and business education; non-bank financing (e.g. leasing and micro-financing institutions lending to small firms); alternative loan products (e.g. alternative collaterals); etc.
	Targeted refinancing lines	Encourages commercial banks to provide loans to SMEs	Banks may still be reluctant to lend to SMEs	Adjusting discounted rate offered for refinancing and maximum commercial rate allowed under the scheme for loans to SMEs
		Default risk stays entirely with commercial banks: most profitable projects selected	Firms in the “missing middle” excluded from bank loans  Need for Central Bank to increase monitoring of funds use	Same as above (policies for “missing middle”)

**Table 11. Examples of fiscal incentives for employment creation**

Country / Region	Eligibility criteria and tax incentives
<b>Sub-Saharan Africa</b>	
Botswana	5 to 10 years of CIT exemption for projects that obtain a Development Approval Order by the Minister of Finance and Development Planning, i.e. projects regarded as beneficial to the development of Botswana's economy or the economic advancement of Botswana citizens in terms of: (1) Job creation for Botswana citizens; (2) The company's training plans for Botswana citizens; (3) The company's plans to localise non-citizen positions; (4) Botswana citizens participation in company management; (5) Amount of equity held by Botswana citizens in the company; (6) The location of the proposed investment; (7) The project's effect on stimulation of other economic activities; (8) The project's effect on reducing local consumer prices.
Nigeria	<b>Labour-intensive mode of production</b> incentive: industries with plants, equipment and machinery operated with minimal automation. Where there is automation, such automation should not be more than one process in the course of production. Tax credit of 15% for 1,000 or more employees; 7% for 200 employees; 6% for 100 employees and so on.
Rwanda	An international company which has its headquarters or regional office in Rwanda is entitled to a preferential CIT rate of zero per cent (0%) if it fulfils 6 requirements, among which is "to <b>provide employment and training to Rwandans</b> ".
South Africa	The Employment Tax Incentive (ETI) is an incentive aimed at encouraging employers to hire <b>young work seekers</b> . It was implemented with effect from 1 January 2014. ETI reduces the employers cost of hiring young people through a cost-sharing mechanism with government while leaving the wage received by the employee unaffected.
	Employers in SEZs are allowed a tax reduction in respect of qualifying employees, up to a prescribed monthly amount.
<b>Asia</b>	
India	Manufacturing units employing at least 50 regular workers are eligible for an income tax <b>deduction of up to 30% of the additional wages paid to the new regular workmen</b> employed for three assessment years, provided that the increase in workforce is at least 10%.
Papua New Guinea	Firms producing a manufactured product <b>never before manufactured</b> in Papua New Guinea or a product which is manufactured but where import substitution is incomplete, are entitled to a <b>wages subsidy payment</b> (rather than a tax incentive) for up to five years, based on a percentage of area-specific minimum wage of each full time citizen employee. In the first year, the subsidy is equal to 40% of the prevailing minimum wage. This declines to 30%, 20%, 15% and 10% in subsequent years.
Philippines	Tax incentives available to enterprises registered with the Board of Investments (BOI) include: <ul style="list-style-type: none"> <li>• Deduction of 50% of the wages of additional skilled and unskilled workers in the direct labor force if the prescribed ratio of capital assets to annual labour is met, and 100% of the incremental labour expense if the activity is located in less-developed areas. This incentive is valid for the first five years from date of registration and cannot be availed of simultaneously with income tax holiday.</li> </ul>
	In order to benefit from fiscal advantages, companies engaged in specified priority activities must register with the Board of Investment. BOI-registered companies enjoy one extra year of CIT exemption in some specified cases including the following: <ul style="list-style-type: none"> <li>• The ratio of total imported and domestic capital equipment to the number of workers for the project does not exceed US\$10,000 to one (1) direct labor.</li> </ul>
Vietnam	<b>Female and ethnic minority employment incentives</b> 1. Production, construction or transport enterprises which employ many female laborers are entitled to reduction of enterprise income tax amounts equal to additional expenses

Country / Region	Eligibility criteria and tax incentives
	<p>paid for female laborers, including:</p> <ol style="list-style-type: none"> <li>a. Expense for job re-training;</li> <li>b. Salaries and allowances (if any) for teachers in crèches or kindergartens organized and managed by the enterprises;</li> <li>c. Expense for additional medical check-ups in a year;</li> <li>d. Post-natal allowances for female laborers. The Ministry of Finance shall, pursuant to the labor law, coordinate with the Ministry of Labor, War Invalids and Social Affairs in specifying allowance levels mentioned in this Clause;</li> <li>e. d) Salaries and allowances for female laborers who return to work during their prescribed maternity leave.</li> </ol> <p>2. Enterprises which employ ethnic minority laborers are entitled to reduction of enterprise income tax amounts equal to additional expenses for job training, housing subsidies, social insurance premiums and health insurance premiums for these laborers, if they have not yet received the States supports under regulations.</p>
Sources:	<p>Botswana: Botswana Income Tax Act, Ch. 52:01, section 52. <a href="http://www.burs.org.bw/phocadownload/Revenue_laws/CAP%2052-01%20Income%20Tax%20Act.pdf">http://www.burs.org.bw/phocadownload/Revenue_laws/CAP%2052-01%20Income%20Tax%20Act.pdf</a></p> <p>Nigeria: Nigerian Investment Promotion Commission. <a href="http://www.nipc.gov.ng/index.php/invest-in-nigeria/investment-incentives.html">http://www.nipc.gov.ng/index.php/invest-in-nigeria/investment-incentives.html</a></p> <p>Rwanda: Investment Code 2015, Annex.</p> <p>Papua New Guinea: PKF Papua New Guinea Tax Guide 2013 and <a href="http://www.pngcanberra.org/investment/incentives.htm">http://www.pngcanberra.org/investment/incentives.htm</a></p> <p>Philippines: Omnibus Investment Code, 1987, Art.39 (b). <a href="http://www.doe.gov.ph/doe_files/pdf/OCSP/eo_226.pdf">http://www.doe.gov.ph/doe_files/pdf/OCSP/eo_226.pdf</a></p> <p>PwC (2015) Investment Incentives in the Philippines, p. 7. <a href="https://www.pwc.com/ph/en/business-guides/assets/documents/pwc-investment-incentives-in-the-philippines-2015.pdf">https://www.pwc.com/ph/en/business-guides/assets/documents/pwc-investment-incentives-in-the-philippines-2015.pdf</a></p> <p>Vietnam: Decree 124/2008, Art. 17. <a href="http://www.moj.gov.vn/vbpq/en/lists/vn%20bn%20php%20lut/view_detail.aspx?itemid=10757">http://www.moj.gov.vn/vbpq/en/lists/vn%20bn%20php%20lut/view_detail.aspx?itemid=10757</a></p>

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