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INDUSTRIAL INVESTMENT INCENTIVES, IMPORT SUBSTITUTION AND EXPORT PROMOTION

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1 Some views on the existing Investment Incentive Code of the Reoublio of Liberia, April 15, 1969. The Open Door Policy with its Objectives, as cited in the code itself and shown below:

THE SENATE AND HOUSE OF REPRESENTATIVES OF THE REPUBLIC OF LIBERIA IN LEGISLATURE ASSEMBLED

Recognizing the great benefits which have come to the nation from the Open Door Policy which has provided freedom of movement of capital, including the repatriation of dividends, profits and capital; and

Taking into account the great incentive to saving and investment which a reasonable tax structure provides in the absenoe of hampering restrictions; and

Convinced that a sound currency and monetary system, free convertibility, and the absence of articicial regulatory pressures are necessary and conducive to the maintenance of confidence in the economic progress of Liberia; and

As further evidence of a desire on the part of the Government of Liberia to cooperate to the fullest extent with foreign and domestic investment in Liberia to the mutual advantage of Government, people and the participants; and

And in further testimony of a deliberate desire to encourage the maintenance of an atmosphere of mutual confidence and common interests;

It is enacted by the Senate and House or Representatives of the Republic of Liberia, in Legislature Assembled; etc. is a very strong Incentive by itself to attract investors, especially in the concession business, or exploitation of the Liberian natural resources.

To attract the investors investing in the field of manufacturing in Liberia it was necessary to find also some other incentives regulating the existing fiscal taxation system. These incentives i.e. tax benefits, examption from Custom duties and Income taxes are enacted within the Code. The Investment Incentive Code of the Republic of Liberia, adopted April 15, 1966, is such a trial in promoting the development of industralization and manufacturing in Liberia .

The Code by itself offers very wide possibilities in acquiring benefits and privileges, loosely regarding the proper interest of Liberia. This mainly appears from the uncleared meaning of an approved new project, that is really contributing to the economic growth and development of the country, and to what extent. Therefore decisions of the Authorities granting benefits of the Code to a Sponsor, might not completely comply with the growth and development.

The purpose of this paper is an attempt to definte and quantify when an approved new project is really contributing to the growth and devlopment of Liberia. Also, which and how much incentives could be and should be granted to it. In this approach the existing taxation system is fully regarded.

The Free Monetary System and Freedom of Movement of Capital

The free convertibility of currency and the free monetary system, without any restriction, as they are in Liberia for the time being, are embarrassingly affecting the development of manufacturing. Any manufacturing or industrial venture has to be from the very beginning competitive against imported goods and products. That means, also for it to be very efficient, at the same time. If, the project would be strongly protected then the existing taxation system prescribes, if would be allowed to be less efficient, and the existing free system would be affected. The extent of such an effect would also have an impact on the existing freedom of currency and monetary system.

To start an efficient business or operation, in the case of Liberia, means to be competivitive in the world market, at the same time, and the extent of it should be in the economy of scale from the very beginning, too.

The Liberian limited local market does not justify in many cases such an extent of scale. For reason of risks in capturing the export market in short time, and of a usual (not so profitable) starting period, there are too many unknowns for investors to start a new manufacturing, unless the project is really justified and approved. This could be also the reason of the slower development of manufacturing in Liberia. That problem is indicated herein to be also discussed how to promote the development of manufacturing.

From an economic standpoint, to promote the import substitution and exports, having apparently advantages, is possible by the adjusting of custom duties and the value of local currency. That could promote and protect the local manufacturing. The local market and prices should not be necessarily affected, if accordingly adjustments on duties and local currency value have been done and for this purpose the existing monetary, tariff and fiscal system have to be revised.

In the case of Liberia, having the U.S. dollar as its own currency, to apply the economic measures mentioned above, means to introduce a new local currency. Also, if in par with U.S. dollar, the new local currency might affect the existing Open Door Policy climate because of imposing and artifical control on the freedom of movement of capital. The introducing of a local currency likely would offer some advantages, as establishing foreign exchange reserves, additional benefits of foreign trade balance, local savings etc. but the contrary effect on the business and investment olimate, as well as on the future monetary security, could not be predicted.

Under the existing Liberian circumstances few projects, with some comparative advantages are likely to subsitute food and consumer imports, where the economy of scale meets the local market or where the export prospects exist.

In the export market, Liberia has advantages of concessions, iron ore, rubber, lumber, timber or higherly processed wood, and few materials.

In export of tropical agricultural products, there are some disadvantages because of the Liberian absence from various overseas economic groups, affiliations or organizations. How to overcome those disadvantage is not only question of economy.

Projects Contributing to the Growth and Development

A project that is showing a positive sum of National economic benefits (costs) and the National value added is to be considered as a growth and development contributing project. (See the explanations herein).

To the contrary, a project aggregating a negative result should be considered unfavorable, because of draining national benefits out of the country, applying the existing taxation and fiscal system.

This is a general significant outcome that should be mostly regarded.

The projects to which the incentives should be granted, had to have fulfilled another criterion, too, and that is a consequence of the National Productivity of capital, working for the country. A tentative rate could be in the order of magnitude of 0.1. (10 percent). In that case, a project would assure a reasonable attainment of development trends. If, this rate is lower than that which is mentionedd above, development trends would be too slowly promoted, to be regarded by the code.

A substantial project or a priority project from the Government point of view should create a new National Value Added, National Income, bigger than 0.1 percent of the value of Gross Domestic Product, complying in the same time with both of the above mentioned criteria, the National benefits and productivity of capital.

Also, through such a priority project considerable investments in the welfare and infrastructure should be made.

The extent of benefits, going to be granted by the code, should be in an order of the positive differance of the new total National benefits.

Some priority projects with a long-term influence on development might be treated more flexible.

<u>Some Observations and Recommendations on the Code:</u>

The foregoing discussion could explain and clarify the meanings of development and national benefits to Liberia in the Investment Incentive Code (1966), treated in its sections and paragraphs: 2-1; and 4(b-II). (See the attached Code) - The imposed criteria should be regarded.

For consideration as a substantial expansion of existing business facilities the expansion should be equal to or more than 50 percent of the existing business and be in accordance with the priority selection. Section: 2-2; 3(2).

Tariff protection should be discussed and conditionally applied only in the case of priority projects. Section: 5(c); 4(b) (II);

To define the minimun employment of Liberian could be also interesting. Section 6(a). This question could be discussed widely.

The sense and advantage of the Investment Incentive Code could be expected only if there is an institution really following-up the implementation of projects and control them. (No Control, No Law):

<u>Explanations and discussion of criteria</u>

National Value Added (National Income) is the part of the value added allocated to Liberia, Liberian citizens or to the Government, through wages, salaries, supplements, taxes, royalties, profit sharing, capitalization of Liberian capital invested, etc. (Return to Labor and Capital).

Productivity of capital is a quotient of the value added divided by total capital invested,* indicating the rate of capitalization. Natural productivity of capital is taking into account the national value added. That is the rate indicating the return of labor and capital to Liberia.

National economic benefits are all the benefits deriving from national value added (Government Revenues, savings of foreign exchange, investment in welfare, education and infrastructure, uses of local resources; as well as services, utilities, transportation etc, as not direct measurable benefits).

Investment in welfare and infrastructure should be considered as benefits to the Nation, spread and divided through the period of depreciation and amortization life of a project. Those benefits should be added to the national income and excluding from the capital invested, for the purpose of reckoning of the national productivity of capital.

Conculations and determination of the criteria proposed and other data should be reckoned and taken as the average outcome from the project during its depreciation and amortization lifespan.

The first criterion, the positive sum of National value added and National economic benefits speaking for itself, i.e. only in positive, a project can contribute to the growth and development of the country.

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*/ Including both equity and loan capital.

The second one, the National productivity of capital is considered as an interest rate, at which the invested capital is working for the country. Regarding the same principles of capital investing, the interest rates of capital return or recuperation should be resonable and heedful. If, it is very low, there is not interest to invest in such a venture, indeed. To be resonsonable one depends on the economic plight in the country and the projects concerned. Usually, foreign investors are willing to invest in developing countries in the projects, which assures an interest rate of capitalization higher than or, at least, the same as they can achieve in developed countries. Capitalization rates do direct the capital flow, are in average as high as 10 to 12 percent of the value of capital invested. Therefore was taken for this criterion, as a tentative rate of the National productivity of capital 0.10 or 10 percent, as a rough approach how to quantify the criterion. The approach from the stand point of capital invested enables to estimate how much of the national benefits is really drained from the country.

An instance of the criterion in the iron ore concession business is shown in the following table.

HYPOTHETICAL EXAMPLES
((figures in million dollars)

COMPANY	A	B	C	D*
Total Value Added	50.8	18.0	14.9	14.4
National Value Added	12.7	2.7	2.5	6.2
Total Productivity of capital	0.167	0.203	0.322	0.335
National Productivity of capital	0.042	0.031	0.054	0.144
Value of Production	64.3	27.2	20.7	19.5
Total Investment, at cost	304.0	88.3	46.4	43.0
Depreciation and Interest	29.3	11.3	3.7	2.3

* National shares in equity and loan capital are about 33 perdent.

Comparing the National productivity of capital from the above tabl. it is obvious that the company D mostly contributing to the country in a relative sense. In the same term the company A should create a National Value Added at least 3 times bigger, than it does at the present. It is not always possible to get in a proposed venture immediately the whole benefits, but the way is shown how to approach realization of better benefits. If, the structure of the venture does not allow to gain whole benefits through labor and taxation and profit sharing, then some participation in equity and loan capital, total capital invested should be considered, to fulfil or to reach the criteria, i.e. to assure a better trend of development.

At least, a reasonable positive trend of GNP and lessening the gap between the GDP and GNP should be assured. In such a case, also the contribution to the country will be reasonable, too.

Few other examples are shown in the following tables.

MANUFACTURING ESTABLISHMENTS
(in thousand dollars)

	Rum & Gin	Soft Drinks	Clinker Grinding	Brewery
Total Value Added	64.9	189.0	353.1	942.0
"Natural" Value Added	14.9	61.8	57.9	436.0
Total Productivity of capital	0.276	0.472	0.160	0.362
National Productivity of capital	0.064	0.154	0.026	0.168
Value of Production	133.8	287.7	1,489.3	1,433.0
Total Investment, at cost	233.8	400.0	2,210.0	2,600.0
Depreciation and Interest	50.0	73.6	201.0	273.0

In the case of the Clinker Grinding Plant the "National" productivity of capital is very low and the contribution to the country is very low, and slow, too.

Rum & Gin distillery is enjoying full exemption from raw material import duties and income tax, and therefore its national productivity of capital is so low.

PROPOSED MANUFACTURE PROJECTS
(in thousand dollars)

	Paper con-servation	BATA Shoes	Cement Blocks
Total Value Added	96.0	142.0	9
"National" Value Added	35.0	112.0	9
Total Productivity of Capital	0.520	0.370	2.2
"National" Productivity of Capital	0.190	0.290	2.2
Value of Production	378.0	635.0	55.0
Total Investment, at cost	184.0	385.0	4.0
Depreciation and Interest	30.0	43.0	1.0

SOURCE: 3rd periodic report (SIS) by S. Tezak, filed with DPEA, 1969

In the starting period, in practice, all new industrial activities are encouraged by some or whole benefits of the Investment Incentive Code, diminishing the contribution, without prospects if some projects will better it, also, after the granted incentives expire.

The development of manufacturing in Liberia is affected by a very limited local market, by US dollar used as local currancy, by the existing monetary system and by the absence from any economic groups, that could especially promote export of agriculture products, natural or processed.

In order to appraoch that problem of manufacturing development, there are two ways to do it. One is to find likely projects and realize them from the Liberian standpoint and the other is the co-operation and sharing the export market with the organization, which can assure it. From these points of view two groups of project could be established: Liberian and the projects in co-operation.

Likely Liberian Projects:

- From Rubber Articles (mattresses, cushions, upholstery) - local and exports -
- Paper conversation (packing and toilet products)-local -
- Knitting of wearing apparel - local and export -
- Deversification of fresh, frozen, and processed fish and meat products - local and export -
- Fresh and preserved vegetable and fruit - local and export -
- As a secondary step of plantation farming and breeding: vegetable oil and fat refinery, small and medium scale of sugar cane juice (rum) and sugar production, fruit processing, meat processing (swine, goats).

Projects in co-operation, with access to the world market:

- Wicker products of bamboo, reed, rattan, grasses, piassava: curios, mats, baskets, furniture: - export and local -
- Furniture in parts, folding, of solid and veneered tropical hardwood - export - local -

- Veener and plywood - export - local -
- Paper and pulp - export and local -
- Leather shoes (Bata) - Local and export -
- Processing and canning of fruit, fresh, crustacean and other food
- Mineral exploitation and dressing beneficiation (Kyanite, Barite).

Those are some examples where manufacturing prospects are likely.

In the case of introduction of a new local currency there will be more probability of establishing and implementing more industrial and manufacturing projects, but the impact of the new local currency on the Liberian economy in whole is completely unknown.

Monrovia. August/September 1969.