
Fiscal Incentives Revisited

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Long history of providing investment incentives to preferred sectors

Post war period: new and necessary industries

1967 Investment Incentives Act

1970 Export Incentives Act

1983 Batas Pambansa 391

Labor intensive activities

Export activities

1987 Omnibus Investment Code

SHIFT

Post war: Reconstruction

IN

Employment generation and
Export promotion

FOCUS



Recent years:
from attracting investments
to preferred sectors
to simply “attracting”
investments

Conflicting Objectives

- Critical need for revenues
- Competitiveness with other countries in the granting of fiscal incentives to attract FDI

Clear need for a more comprehensive evaluation of the investment incentive system.

Objective of the Paper:

to clarify some of the issues and hopefully provide some useful suggestions for reforms for rationalizing the fiscal incentive system.

Focus: investment incentives for industrial policy
in particular, focus on the investment incentive system embodied in the omnibus investment code

General Principle

Justification/Rationale for Government Intervention:
to correct for market failures/distortions
(externalities, public goods, imperfect markets)

Fiscal incentive:
one form of government intervention

Primary role of the investment incentives:

to correct for market failures and distortions

→ channel investments to the "desired" sectors which will maximize growth

→ ultimate objective: industrial (agro-industrial) development leading to faster growth and increased overall welfare

Need to keep in mind...

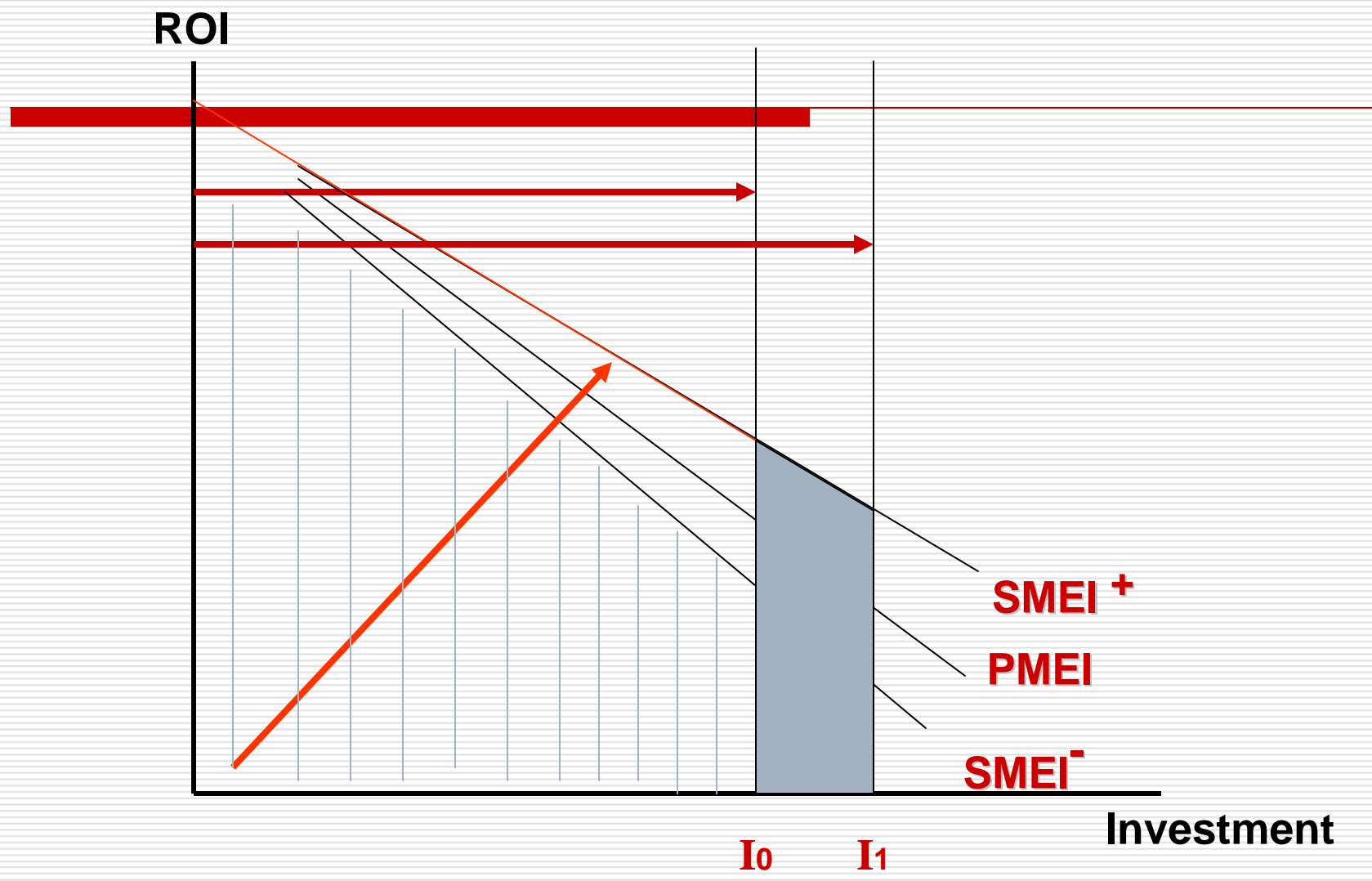
Objective of Fiscal incentives:

Is it mainly to induce more investments, *per se*?

Fiscal incentives not likely to increase level of domestic saving/investment

It is the overall fiscal and monetary policy which determines the level of domestic saving and investment.

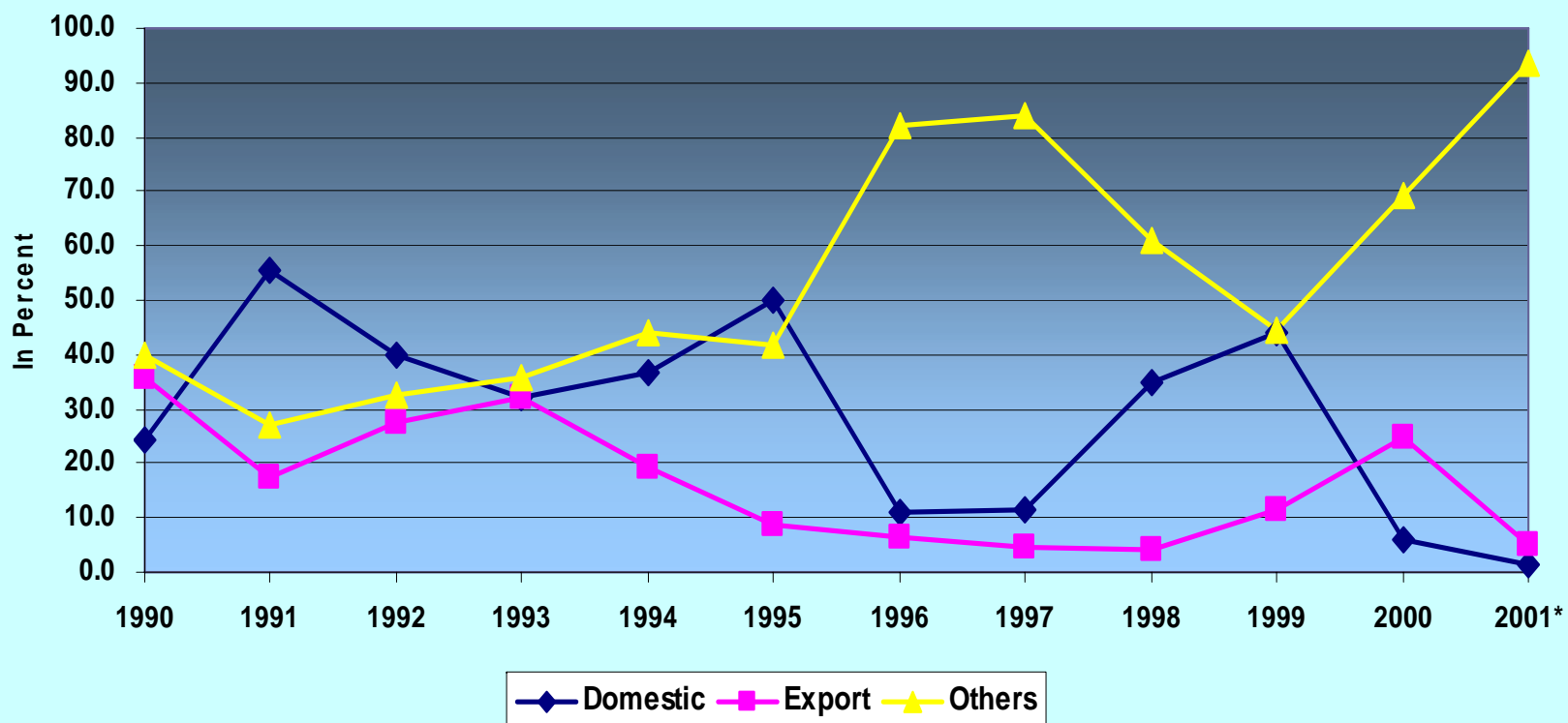
The question of attracting direct foreign investments



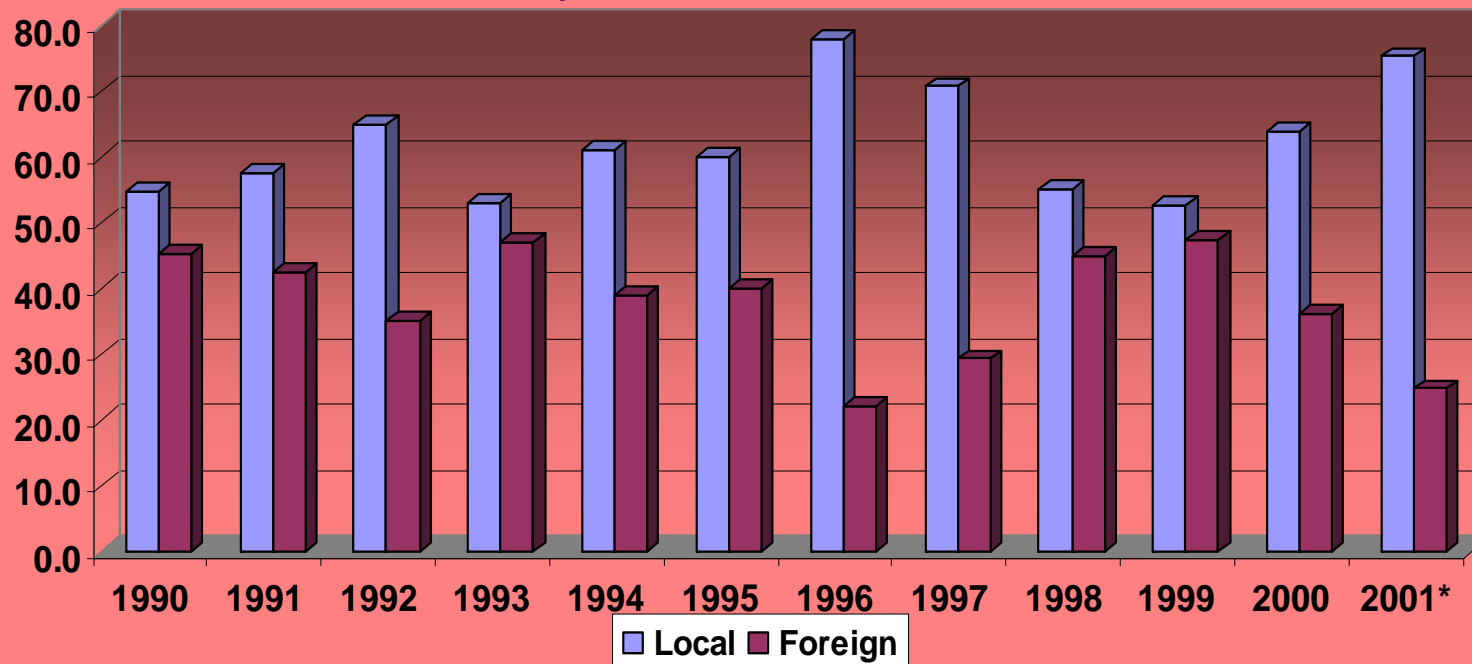
Some indicators

- Export, Domestic, Others
- By Equity: Domestic or foreign
- Average Size

BOI Approved New and Expansion Projects, By Project Type



**BOI Approved New and Expansion Projects,
By Source of Investments**



BOI Approved Projects Under E.O. 226

Year	NEW and EXPANSION PROJECTS			AVERAGE SIZE (Mil P)		
	Project Cost (Mil P)	Equity Investments (Mil P)		No. of Projects	Project Cost	Equity Investments
		Local	Foreign			
1985	2,742.09	699.99	869.72	136	20.16	11.54
1986	2,191.96	1,012.43	341.80	114	19.23	11.88
1988	28,720.16	6,655.05	7,658.81	616	46.62	23.24
1990	99,895.50	21,961.38	18,148.59	755	132.31	53.13
1991	74,179.02	18,960.81	14,044.52	490	151.39	67.36
1992	39,624.82	10,360.14	5,597.49	389	101.86	41.02
1993	70,269.30	13,716.44	12,185.98	386	182.04	67.10
1994	451,354.85	96,050.89	61,287.30	728	619.99	216.12
1995	299,279.73	59,134.65	39,492.10	383	781.41	257.51
1996	382,464.47	86,081.08	24,532.69	378	1,011.81	292.63
1997	552,886.85	129,731.52	53,832.69	434	1,273.93	422.96
1998	264,746.93	44,475.09	36,431.83	198	1,337.11	408.62
1999	106,899.17	21,631.16	19,571.71	192	556.77	214.60
2000	43,918.09	11,710.70	6,602.28	145	302.88	126.30
2001*	88,410.05	42,174.71	13,881.51	123	718.78	455.74

*Jan-Aug

Foregone Revenues

Assumptions:

- Income Tax Holiday (ITH) Availment= 5yrs. (ave)
- Return on Investment (ROI)= 15%
- Corporate Income Tax = 32%
- Realization of Investments = 75%
- Investment would come in regardless of fiscal incentives

$$FR_T^U = (.75) \left[\sum_0^4 (I_{T-t}) (.15) (.32) \right]$$

Foregone Revenues

Additional Assumptions:

- **50% of Foreign Investments are attracted by incentives**
- **Local Investments are determined by fiscal and monetary policy**

$$FR_T^E = .75 \left[\sum_0^4 I_{T-t}^L (.15) (.32) + \sum_0^4 (.50) I_{T-t}^F (.15) (.32) \right]$$

Foregone Revenues

Additional Assumptions:

- Local Investments are determined by fiscal and monetary policy
- No Foreign Investments

$$FR_T^L = .75 \left[\sum_0^4 I_{T-t}^L (.15) (.32) \right]$$

FOREGONE REVENUES

In Million Pesos

Year	FR_T^U	FR_T^E	FR_T^L
2000	15,645.63	13,108.15	10,570.66
1999	18,536.92	15,407.42	12,277.93

BOI estimate (1999): **P4.67 B**

Implication:

- Low return on investments?
- Low realization of investments?

Cost: just one side of the equation

Do benefits justify the costs?

Fiscal incentives COST. And errors could be costly.

Choose sectors with clear benefits to society.

Guidelines in rationalizing the Investment Incentive System:

- Sound economic basis (first-best consideration)
 - Ease/cost of administration (second-best solution)
 - Simplicity without unduly compromising sound economic principles
 - Transparency
 - Minimize potential losses
-

Investment incentive scheme must be more focused and discriminate.

Comparative advantage not enough basis to warrant very generous incentives.

Fiscal incentives cost.

Market Returns lower than Social returns.

Avoid granting incentives to already highly profitable activities

Recommendations

- ❑ For non-traditional exports, clear rationale
- ❑ For industrial promotion policy: limit the number priority areas (IPP)
- ❑ Practice fiscal incentives accounting (and reporting)
- ❑ Reporting requirements(well-designed) to allow for meaningful evaluation. Review the IPP areas every two (or three) years and prepare a new Short List of IPP areas

Recommendations

- ❑ Incentive availment- not too long a period
- ❑ Subsume existing fiscal incentive schemes that are clearly for industrial policy, leave other social objectives in the hands of the appropriate government agency (DENR for environment, DOH for health, etc).

Finally, if the paramount concern is to increase the level of domestic investment,

→ thru overall fiscal and monetary policy:
e. g. lower corporate income tax, etc, which are universally applicable.

→ Also, thru a more active non-fiscal investment promotion by BOI

Thank you for your attention.

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