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THE MAIN INSTRUMENTS OF INDUSTRIAL POLICY IN LATIN AMERICA  
by the Industrial Development Division, ECLA

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## THE MAIN INSTRUMENTS OF INDUSTRIAL POLICY IN LATIN AMERICA

Although some countries have attempted to plan their industrial development, their efforts have not always been reflected in a reorientation of the measures and instruments for bringing it about. It has been this group of instruments, established at various states of economic development to meet different kinds of problems, which in the last analysis has determined the pace and pattern of industrial growth.

Two of the three main groups of instruments or measures which form part of industrial policy in the Latin American countries are analysed here, i.e., those for the protection and those for the promotion of industrial development.<sup>1/</sup>

Even though the analysis is confined to these few instruments, it is hard to say, on the basis of the available material, how effective each one has been in achieving the objectives set in the industrial development plans. First, each instrument is used to achieve more than one objective and, secondly, a measure may have unexpected side-effects. Therefore, the intention here is merely to indicate the various forms these instruments have taken and the extent to which they are being applied in a group of countries in the region.

### 1. Instruments for the protection of industry

The Latin American countries use a wide range of instruments for protecting their industry. Some measures, such as tariffs, specific taxes, import surcharges, prior deposits and multiple exchange rates, affect prices; while others, such as import quotas, prior licences and foreign exchange control, do so only indirectly. Other economic policy measures, such as tax policy, credit policy and direct government action through the creation of external economies, indirectly affect the level of protection.

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<sup>1/</sup> The third group, instruments for channelling financial resources into the industrial sector, are described in "Industrial policy in Latin America" (E/CN.12/877; ST/ECLA/Conf.37/L.7).

There have been frequent changes in the system used for protecting industry in the last few years, primarily aimed at simplifying or restructuring the system itself, or at extending the margins of protection to new products. The countries which have made most progress in industry are those which have adopted the most flexible and most easily applied protectionist policy and have endeavoured to limit the excessive protection accorded to established industries.

This has not happened in most of the countries at an intermediate or less advanced stage of industrial development, where a high level of protection still exists side by side with a whole battery of usually complex controls.

The following table shows in simplified form the group of instruments currently used to protect industry in the countries considered.

SELECTED LATIN AMERICAN COUNTRIES: INSTRUMENTS CURRENTLY USED TO  
PROTECT INDUSTRY.

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<u>Argentina</u>	Tariff, prior deposits for specific products, prohibition systems.
<u>Brazil</u>	Mainly the tariff.
<u>Mexico</u>	Tariff, prior permits.
<u>Colombia</u>	Tariff, lists of products, prior licences, prohibition systems, prior deposits, multiple exchange rates.
<u>Chile</u>	Tariff, prior deposits, lists of products, prohibition systems, additional taxes.
<u>Peru</u>	Tariff, foreign exchange certificates and multiple exchange rates.
<u>Ecuador</u>	Tariff, prior deposits, lists of products.
<u>Bolivia</u>	Tariff, prohibition systems.
<u>Venezuela</u>	Tariff, prior licences.
<u>Dominican Republic</u>	Tariff, quantitative restrictions, prohibition systems, prior deposits.
<u>Paraguay</u>	Tariff, prior deposits, foreign exchange surcharges, complementary and additional duties, consular fees.
<u>Uruguay</u>	Tariff, foreign exchange surcharges, multiple exchange rates.

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(a) The customs tariff

The instrument for the protection of industry which is most widely used at present and which has the greatest effect in some countries is the customs tariff. Its importance and the way in which it is applied vary greatly from country to country, as regards not only the nomenclature used - the Brussels Tariff Nomenclature (BTN), the Central American Standard Customs Nomenclature (NAUCA) or the Standard International Trade Classification (SITC) - but also the unit to which it applies, whether in terms of value (c.i.f. or f.o.b. values, customs valuation, special values established by the competent authority, etc.) or quantity (weight or number of units), the way it is applied (ad valorem or specific rates, or a combination of both), and the amount of the duty involved.

In Argentina the duties are calculated for each import item and consist of a single charge on the c.i.f. value, except where the Executive is authorized to establish index values for certain articles whose manufacture it wishes to promote, on which the customs duties are applied. In Brazil, variable ad valorem tariffs are levied on the minimum value in dollars which the Customs Policy Council establishes for each product. In Mexico, as in Argentina, the duties are calculated separately for each product, but they comprise both specific and ad valorem charges.

Before the Cartagena Agreement came into operation and change the situation, the tariff systems in the signatory countries presented the following characteristics. In Colombia, ad valorem rates had been in force only since 1965, and the Customs Policy Council could modify them where it deemed appropriate.<sup>2/</sup> In Chile, the tariff had been in force since 1929 (Law 4321) and it comprised both specific and ad valorem duties. The former were applied on the basis of taxable units in terms of weight: this was the only form of import control up to 1936, when ad valorem taxes were introduced; these were later incorporated in the tariff<sup>3/</sup> and levied on the c.i.f. value of the goods (including import duties and charges); the rates varied greatly according to the category of products concerned.

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<sup>2/</sup> Legislative Decree N° 3168 of 1964. It provides that such modifications may not exceed 30 per cent of the c.i.f. value of the import, except in the case of products from the ALALC region, which come in duty free.

<sup>3/</sup> Decree N° 772 of 1943.

There were further modifications in 1962, and again in 1967, in which year the BTN was adopted as the nomenclature, and changes were introduced both in the rates and in the way the tariffs were applied. The charges listed were based on a single ad valorem scale, prior deposits for imports were abolished, and specific tariffs were applied only to prevent dumping instead of an anti-dumping tax and to stabilize prices. In Peru, the tariff did little to protect local industry until 1964; subsequent reforms, particularly in 1967, were designed to alter this situation and the tariff was applied more rationally by scaling the tariff charges according to the type of goods.

In spite of the changes introduced in Ecuador's tariff in 1962 and 1964, it continued to be a means of stepping up fiscal revenue rather than an instrument for the promotion of industry. The existing system <sup>4/</sup> establishes a single rate for specific and ad valorem duties on the c.i.f. value of the goods classified in the following two lists: (a) essential goods; (b) luxury goods and locally manufactured products. Higher charges are levied on the last two groups of products than on those included in the first list. The Central Bank supervises the application of the tariff and the Technical Tariff Policy Council advises the Ministry of Finance on any changes that need to be introduced.

Lastly, in Bolivia, the Executive is empowered to modify the duties and charges in the existing tariff (which is predominantly protectionist); the Ministry of Finance may also eliminate or reduce the duties and even prohibit imports.

Venezuela's tariff is based on NAUCA, which is being revised and brought into line with the BTN with a view to the subsequent adoption of the NABALALC nomenclature. Its main feature is the low level of duties. The tariff has only recently taken on the protectionist character common to most of the Latin American countries. For many products covered by trade agreements with other countries, prior licences have played a protectionist role, since under those agreements, the tariff cannot be raised.

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<sup>4/</sup> Decree N° 746.



Paraguay's tariff combines specific and ad valorem taxes; the latter are levied on the c.i.f. value of goods. Lastly, in Uruguay, the tariff is applied by means of an ad valorem tax, and the basis for calculating it differs according to whether or not the goods have an official customs value. If they have, the tax is calculated on the basis of a value which - although it has recently been adjusted - generally seems to be below the real value of the goods, and if they have not, the tax is based on the value shown on the consular invoices concerned. There are also specific duties for special types of products.

If tariff structures are analysed by type of product, the following facts are to be noted. With a view to encouraging more efficient use of installed industrial capacity, Argentina and Brazil have recently introduced changes in their tariffs, reducing those on final consumer goods which compete with domestic production, and raising the level of protection for raw materials and intermediate products, capital goods coming between the two.

The opposite is true of the rest of the countries analysed. Colombia, Venezuela, Peru, Chile and Ecuador apply the highest tariffs to final consumer goods the greater the possibility of producing them locally, the higher the tax to luxury goods. The duties on intermediate products, raw materials and capital goods on the whole are not so high as on consumer goods.

In Bolivia, tariff charges on products that are not manufactured locally are generally low, while imports of raw materials and capital goods not produced locally are duty free. In Paraguay, the liberal way in which the tariff is applied, combined with the large volume of illegal imports, largely negates any role tariffs might play in promoting domestic production. In Uruguay the tariff by product is not rationally applied in certain cases; for example, lower duties are levied on certain finished products than on the raw materials that are essential inputs for their manufacture.

(b) Other tariff mechanisms

This category comprises a number of mechanisms and controls which help to raise or to graduate the levels of protection for domestic industry, such as the application of different tariffs to products on different lists, the partial or total banning of imports on certain lists, systems of prior deposits, prior licences, special import procedures for certain products and differential charges (tariff surcharges, etc.).

These instruments are widely used in many Latin American countries, since it is easier to use them than to use the tariff to change the degree or level of protection accorded to certain products whose importation it is desired to discourage either temporarily or permanently.

In Argentina, this type of mechanism includes prior deposits for specific products (in national currency and equal to 75 per cent of the cost of the goods, including freight). There is also a ban on imports of certain products which are similar to those manufactured locally.

Brazil abolished the system of two separate lists (special and general categories) in 1967; protection is now afforded by applying variable tariffs on the basis of the minimum value established for each product. In Mexico, the use of prior permits has gradually been replacing the tariff as a protective instrument; their importance can be measured both by the growing number of imports for which they are required (70 per cent of the items in the tariff classification) and by the value of the imports to which they are applied (85 per cent of the total). Import control in Colombia is based on a system which comprises lists of: (a) duty-free products; (b) products for which prior licences are required, accounting for 70 per cent of total imports; (c) imports that are prohibited; it also comprises prior deposits ranging from 10 to 70 per cent of the f.o.b. value of the goods, which is refundable within 180 days.

Chile also has a system list (permitted imports and prohibited imports) and prior deposits (which have recently been reduced or eliminated for some items but still play a highly protectionist role). Prior deposits can be as high as 10,000 per cent of the c.i.f. value of the goods for certain products. The deposit is made in national currency on the date on which the import operation is recorded and it is kept for at least 90 days.

/This system

This system of lists and prior deposits is also used in Ecuador, Paraguay and Bolivia. Venezuela, on the other hand, uses the system of prior licences, and a number of surcharges (additional and complementary taxes, consular fees, etc.) are levied on certain imports which are more in the nature of payments for services rendered and seem not to affect the degree of protection very much.

(c) Foreign exchange policy

Foreign exchange policy, used extensively in the 1930s to stabilize the balance of payments, has lost some of its importance as a protective instrument, although it is still used for the same purpose in some countries. Foreign exchange policy usually takes the following forms in the Latin American countries: control of exchange operations, the establishment of several types of exchange rates (single, multiple, fixed, flexible), the existence of more than one foreign exchange market, and the allotment of foreign exchange through bidding.

Current foreign exchange policy in Argentina, Brazil and Mexico plays little part in protecting domestic industry. In Argentina, all controls on foreign exchange operations were lifted in 1967 and a single exchange rate was established. In 1967 Brazil modified the system that had been in force up to that date, whereby a special category of products could be imported only by acquiring foreign exchange at weekly auctions. The new system eliminates this procedure so that there is only one category and a single exchange rate. This rate has been periodically adjusted since 1968, at shorter and shorter intervals, in consonance with the variations in the internal purchasing power of the cruzeiro. There has also been a single exchange rate in Mexico since 1954, and its parity has not altered.

With the reforms introduced in March 1967, Colombia established two exchange areas: certificates and capital. The first area covers export transactions, and the relevant certificate are freely negotiable. The exchange rate for these transactions was 13.50 pesos to the dollar, but it has gradually worsened. The second area (where the rate was initially 16.25 pesos to the dollar) covers various transactions, such as payments for exports through free ports, payments for invisibles, purchases of gold, external loans not assigned to the certificates market, and capital inflows,

/In 1967,

In 1967, Peru once again introduced the system of foreign exchange certificates which had already been in force in the 1950s. Two exchange rates were established under this system, one for certificates (38.7 soles to the dollar), which was equivalent to a 40 per cent devaluation with respect to the previous exchange rate, and a free rate (a little over 40 soles to the dollar). This measure was aimed at increasing protection for domestic industry and restricting imports.<sup>5/</sup>

Most of Bolivia's imports from 1950 to 1956, particularly of essential goods, were subsidized through the concession of various preferential exchange rates. This system severely limited the possibilities of developing the domestic manufacture of these products. At the end of 1956 the system of subsidized imports was abolished and a single exchange rate was established.

In Paraguay, foreign exchange surcharges complement the tariff in regulating imports. Uruguay has had a double exchange system since 1963; there is an official area, where the rates are fixed by the Banco de la República, and a bank market, with freely fluctuating rates. The Banco de la República periodically adjusts its rates to bring them closer to the bank market rates, and since the end of 1966 they have been practically the same.

## 2. Instruments for the promotion of industry

This heading covers a great many tax, tariff and foreign exchange measures for the promotion of new industries or the expansion and modernization of existing plants. Although they have been in force for many years, it is only recently that they appear to have had much effect, depending on how clearly defined their objectives were and how much cohesion there was between the objectives and the instruments by which they were to be attained.

These mechanisms have of course become more important as protection gradually became less so as the main instrument for the promotion of industrial development, precisely because what is needed is more flexible, deliberate and selective action, which is more effectively achieved through this type of instrument.

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<sup>5/</sup> On 15 May 1970 (Legislative Decree N° 18275<sup>1</sup>), new changes were introduced in the exchange market, which left the control of the use of foreign exchange more or less in the Government's hands. To achieve this, exchange operations have been centralized in the Banco Central de la Reserva and the Banco de la Nación.

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This does not mean, however, that the mechanisms and measures to promote industry grew out of a clearly defined pattern, as far as the objectives aimed at and the function assigned to each are concerned. They were prompted more by certain generally accepted ideas regarding the need to encourage the establishment of industries that would fulfil requirements such as: expanding basic manufacturing to produce new items to replace imports; encouraging the export of manufactures; using more locally produced raw materials; increasing employment; decentralizing industrial development; renewals of industrial plant and equipment; and modernizing some branches of industry.

Among the various instruments used by the countries of the region, industrial development laws are the most important in almost all countries. Although they differ in their actual content, they are very similar in their aims and in the machinery used for their application. Depending on the country, the favoured industries are, "basic", "essential", "in the national interest", "new", and other terms of this kind.

Generally speaking, the emphasis in the development objectives pursued by these instruments has shifted from expanding basic manufacturing by producing more items to replace imports, to greater concern for efficiency and competitiveness and, in some cases, with a policy of using local raw materials to produce special products. This is a corollary of the need to find new sources of dynamism in manufacturing for export as import substitution flagged.

The successful results that were undoubtedly obtained by applying instruments for the promotion of industrial development, could have been much better if certain conditions - absent in the majority of cases - had been fulfilled. The need for these instruments to be related to an organic framework of industrial programming has already been mentioned. A second condition is that efforts must be made to eliminate institutional dispersal: there is a lack of co-ordination between the various ministries, development institutions, commercial banks, the Central Bank, etc. that apply the instruments. Finally, there is a certain lack of continuity in their application, due to frequent changes in the character, scope and aims of the measures taken.

(a) Customs and tariff instruments for the promotion of industrial development

The tariff, which used to be a clumsy and rather unselective protective instrument, has gradually been modified and become a more specific and selective instrument for industrial development. It is its use in this particular way that will be discussed in this section.

The action, effected through various instruments of this kind, has three main focuses: export industries; certain industries considered to be of prior importance ("new", "essential", "basic", etc.); and industrial decentralization.

In general terms, customs incentives may take the following forms:

(i) exemption from export duties and charges; (ii) the drawback system; (iii) temporary admission system; (iv) exemption from import duties and charges; (v) other customs incentives.

Several special decrees or laws authorize the Executive to abolish or reduce customs duties and charges on certain agricultural and industrial export products.<sup>6/</sup> These exemptions may be made in various ways and may be total or partial for any article exported, or they may be selective, applicable only to export industries classified as "essential" or "new", depending on the case.

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- <sup>6/</sup> Argentina: Law 17198/67, article 2.  
 Bolivia: Supreme Decree N° 07366/65, article 11.  
 Colombia: Legislative Decree N° 3168/64, article 1, B and Law 146/61.  
 Chile: Law 16528/66, article 3, and the regulations for its application by Decree N° 1270/66, article 18, paragraph 5.  
 Ecuador: Industrial Development Law (article 17, paragraph 5), and the regulation for its application in Decree N° 738/67 and the Law on The Development of Artisan-type Industry.  
 Mexico: Law on the Promotion of New and Essential Industries of 31/XII/54, articles 3 and 14.  
 Paraguay: Legislative Decree N° 30/52 and Law 202/53, Law 246/55, article 5, B, and Decree N° 16 977/61, article 1.  
 Peru: Law 13270, articles 54 and 98 and Supreme Decree 227-68-HC, article 1.  
 Uruguay: Law 13608/67, articles 3 and 4, and Law 13222/63 and the regulations for its application in Decree N° 25/64.  
 Venezuela: Decree of 31/X/52 and Decree N° 4298/67.

Among the countries that grant this privilege without discrimination are the following: Argentina, whose Executive is authorized to abolish, totally or in part, the charges payable on exports before shipment; Brazil, which in 1966 authorized its Foreign Trade Council (CONCEX) to lift all taxes, quotas and charges applying to exports; Chile, which also exempts export products domestic taxes and charges and does not require a prior deposit for them; and Peru, which extends this treatment to all exports of manufactures. In Ecuador, this privileged treatment is extended to any manufacturing firm whether or not it produces for export. In Bolivia, Venezuela and Mexico, by contrast, the treatment is more selective. In Bolivia, the law for promoting private investment grants such exemptions for the production of goods that will diversify local industry; in Venezuela it only applies to alcoholic beverages (but prior licences are not required for any export of manufactures), and in Mexico, under the law promoting the development of new and essential industries, this treatment is applied to industries classified as "essential and export" industries.<sup>7/</sup>

To the same end, almost all the countries in the region have applied the drawback system, which lowers the cost of exported products and thus makes them more competitive. Under this system the customs duties (and in certain countries the exchange surcharges) on imported raw materials and intermediate products used in the production of export manufactures are refunded to the exporter.<sup>8/</sup>

The drawback is calculated on the percentage of imported inputs in the export product. The authorities that apply this system generally make their calculations on the basis of technological coefficients derived from normal output levels, which are applied to either the c.i.f. or the f.o.b. value of the export product. The drawback may be a total or only

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<sup>7/</sup> These are industries in which domestic processing accounts for over 60 per cent of direct production cost, enterprises producing finished, not intermediate, goods, and that have not yet managed to export in sufficient quantities to cover costs.

<sup>8/</sup> In Colombia this applies also to imports of capital goods for the establishment or expansion of export industries.

a partial refund, and it may be paid to the exporter in national currency, foreign currency, bonds, credits, etc. As a general rule, the refund is made within 180 days from the date of dispatch.

In Brazil and Chile, the drawback system is wider in scope. In Brazil, goods imported under this system are also exempt from consumption taxes and all surcharges not included in service charges, and in Chile all taxes and duties affecting the price of export goods (not only those on imported inputs, but also on locally produced inputs). There are other different patterns in these two countries. While in Brazil entrepreneurs can use the drawback to pay for import effected subsequently, in Chile the Central Bank actually makes the refund in bonds that can be used in paying fiscal taxes, including social security taxes.

In order to get his drawback, the exporter must comply with certain requirements, the combinations of which vary from country to country and which include: classification of merchandise for export, presentation of the documents needed to prove that the goods have really been exported, and proof that the product exported is on the list of products eligible for such treatment, that the inputs and raw materials imported for its manufacture are not locally produced or are not of the required quality, that the value added by local manufacturing is substantial, that it is not an occasional but a regular export, etc.

In the same way as the drawback system, the temporary admission system is used exclusively as an export incentive, and in some countries it is applied to all types of exports of manufactures and in others only to exports of non-traditional manufactures.<sup>9/</sup> It covers exemption from all the duties and charges generally levied on imports (customs duties, prior deposits, etc.), and in some countries extends to consular fees and internal taxes.

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<sup>9/</sup> For certain countries in the region this system is governed by the following decrees and statutes:

Argentina:	Decree N° 5 343 of 1963.
Colombia:	Decree Law N° 444, article 172 to 176 and 178. Decree Law N° 688 of 1967.
Chile:	Customs Statute article 145.
Venezuela:	Decree N° 803 of April 1967.



This system differs from the drawback basically in two ways. In the first place duties are not refunded but temporarily suspended. Secondly, the imported goods which generally come into the country under the temporary admission system must be easily identifiable in the exported product in which they are incorporated. They are generally containers and packing materials, raw materials or semi-processed goods which are not highly processed in the country before being exported (parts and components included in other manufactures; materials used in the packing, mixing and compounding of raw materials and semi-processed products, etc.). Generally speaking, it could be said to apply to what are, to some extent, re-exports. As has been seen, the drawback system, by contrast, covers manufactures with a higher degree of local processing, which is generally the requirement for duty-free entry.

The temporary admission system is widely used and is granted mainly on imports of raw materials and semi-processed products used directly in the manufacture of products that are exported (Argentina, Brazil, Colombia, Chile,<sup>10/</sup> Peru,<sup>11/</sup> Venezuela and Uruguay), products for processing or packing and subsequent re-export (Mexico), parts or components utensils or appliances which supplement apparatus, machines or vehicles for export (Brazil and Uruguay), goods or materials used in packing, preparing or presentation of goods for export. (Brazil, Mexico, Chile,<sup>12/</sup> Peru and Uruguay); and for any kind of merchandise which is re-exported within a certain time limit (Paraguay).

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<sup>10/</sup> The General Customs Board only grants duty-free entry for this kind of merchandise in special cases.

<sup>11/</sup> Only if they are used in the production of non-traditional manufactures for export.

<sup>12/</sup> The Customs Regulations state that this covers bags, wrappings and labels for all kinds of industries, and new and used containers for exporting wine.

To obtain this privilege, the importer and subsequently the exporter must submit a guarantee, a banker's bond or some other kind of security,<sup>13/</sup> to the appropriate authority,<sup>14/</sup> ranging from a very small proportion of the total duties payable (5 per cent in Uruguay for imports not subject to surcharges) to almost prohibitive levels (in Colombia, five times the duties payable for imports that are banned).

In Argentina manufacturers generally feel that the guarantee required is extremely high and so this system is not much used. In Colombia, although the guarantee required is high, the system of temporary admission is widely used, and in Uruguay it has almost replaced the drawback system.

Almost all countries in the region grant exemption from customs duties and charges (exchange surcharges or prior deposits) on imports of machinery and equipment to encourage the establishment of industries that are considered to be of primary importance. Generally speaking, specific requirements must be met before exemptions can be granted. They include the following:

They must be intended for the installation, expansion or re-equipping of industries that are essential, basic, of national interest, etc.;

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13/ Argentina: a bond submitted to the Customs Authority for an amount equal to the duties and charges plus 25 per cent; Brazil: a guarantee of payment of taxes and duties, in the form of a prior deposit and a bond; Mexico: security covering total customs duties and charges and any fines that might be incurred; Colombia: a banker's or other bond presented to the Customs Authority concerned; Uruguay: a guarantee presented to the Ministry of Industry and Trade; and Paraguay: a guarantee presented to the Ministry of Finance.

14/ The following authorities grant duty-free entry:  
 Argentina: Ministry of Industry and Trade; Mexico: Department of Financial Studies and Ministry of Finance and Public Credit. Operations are carried out through the Customs Authority; Colombia: External Trade Institute (INCOMEX); Chile: General Customs Board; Peru: for the import of raw materials and semi-processed products, Department of Industries; for the import of containers, Ministry of Industry and Trade and the Ministry of Economic Affairs and Finance, which work through the Customs Authority; Uruguay: Ministry of Industry and Trade; and Paraguay: Ministry of Finance.

The industries must play a part: in import substitution; in developing new export products; in providing more employment or raising the percentage of locally produced raw materials and semi-processed products;

The industries must help towards geographical decentralization and towards raising the level of industrialization in specified areas of the country;

They must help to improve the country's production techniques by modernizing existing plants or introducing the most efficient machinery for new manufactures;

Their production costs must be reasonable compared with international prices.

In most countries, these exemptions are granted only to national entrepreneurs (except in Argentina and Brazil) and in all of them only for imports of capital goods (and their accessories and spare parts) which cannot be found among the locally produced goods in sufficient quantity or with high enough standards of quality to meet the requirements of the project for which they are requested.

Exemptions may be total (Argentina, Bolivia, Brazil, Ecuador and Uruguay) or only partial, depending on the extent to which the industries benefiting from this treatment increase employment or use more locally produced raw materials or semi-manufactured goods (Mexico, Chile, Peru).

In Argentina, these exemptions are granted under the head of "priority plant and equipment", and each case is decided on its merits, whether the request is made for the installation of plant financed with foreign capital or for carrying out specific industrial projects by local enterprises. In both cases the National Department for Industrial Development carries out a technical and economic appraisal of the project before authorizing the application of this system. In Brazil this incentive is applied mainly with a view to encouraging geographical decentralization, and the exemptions are also granted to foreign enterprises manufacturing equipment in Brazil. Incentives of this kind are applied in Mexico in order to encourage the importation of the most efficient machinery or to modernize the stock of equipment in the industrial section. They are

/granted only

granted only to manufacturing enterprises that actually use the equipment, and intermediaries are expressly excluded. In Colombia, Ecuador, Venezuela and the Dominican Republic, incentives of this kind are authorized mainly for enterprises which create or expand export capacity; in Chile and Peru they are also aimed at decentralizing existing industries and encouraging the utmost use of local labour and raw materials.

This seems to be one of the instruments for the promotion of industrial development which has had the most obvious effect in the establishment of new industries in the region. Its usefulness is still questioned in many countries, however, especially in countries that have gone beyond the early stages of industrialization and are hoping to start full-blown production of capital goods. It seems obvious that if capital goods are allowed in duty-free, this will not help to develop the local capital goods industry. This does not mean, however, that this instrument should be abandoned; but it might well be used more selectively. Its field of application should be gradually restricted until it comprises only those capital goods that, by their very nature, could not be manufactured in the country for a long time to come.

Apart from the customs incentives already listed, there are other forms of promotion in these countries which have to do with tariff policy and are generally directed towards stimulating export industries. Among these the following are of note: (i) customs exemptions on imports of raw materials, intermediate products and containers to be used exclusively in the processing and preparation of products for export (Bolivia, Brazil, Colombia, Chile, Ecuador, Mexico, Uruguay); (ii) the system for replenishing stocks of raw materials, equipment, etc., under which the duties and charges paid on imports of raw materials and intermediate products which are up to foreign standards in quantity and quality and which have been used in the production of manufactures for export are refunded (Brazil, Colombia, Chile); (iii) the system of allowing enterprises to import materials duty-free if they are used, under customs supervision, for the manufacture of products for export. This system is in operation in Chile, in private export warehouses, authorization for which is granted or withdrawn in each case by the Superintendent of Customs and which are supervised by the nearest

customs post. In Mexico this incentive is applied only to industries in border areas. The system also exists in Brazil; (iv) exemption from storage payments (Brazil or Venezuela), or prior import licences (Colombia) and exemption from export licences (Venezuela) are also in this category.

Finally, reference should be made to a feature which is peculiar to the Mexican system of tariff incentives. Prior permits play a very important part as an instrument for the promotion of development, since the aim pursued in applying them is to encourage more intensive use of domestic inputs and a growing share of domestic capital in the investment of the authorized enterprises, which cannot operate without a prior permit.

In the 1960s this system began to be used to supplement other industrial policy instruments of a more general kind. To begin with, it was used with the Manufacturing Programmes, aimed at achieving more vertical integration in manufacturing production. Under these programmes, it was decided to grant prior permits for the import of certain goods by enterprises that would bind themselves to undertake a programme for the local manufacture of such goods, and to incorporate an increasing number of locally produced parts and components.<sup>15/</sup> Subsequently the goods exempt under rule XIV were also subject to the prior permit system.

(b) Exchange instruments

The general aim of the incentives applied under the present foreign exchange policy is to promote non-traditional exports, and they generally consist in different terms and conditions for the repatriation of the foreign exchange earnings on exports which may take any of the following forms: measures that are really credit incentives in Argentina, Colombia and Chile; special exchange rates for these earnings when they reach the country in Colombia and Uruguay; partial or total exemption from charges on foreign exchange operations in Paraguay.

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<sup>15/</sup> Among other successes achieved by this combination of measures were the following: the production of type-writers; progress towards greater rationalization of vertical integration in the motor-vehicle industry; the manufacture of machinery and equipment for the construction industry; the production of diesel engines, clocks and watches, etc.

In Argentina a circular from the Central Bank <sup>16/</sup> established certain time-limits for the return of foreign exchange earnings on non-traditional exports, and these were modified in 1968 by another circular which allowed time-limits to be freely fixed to suit exporters. If he is to take advantage of this measure, the importer must provide proof that the exchange really was earned by the sale of non-traditional products on a foreign market.

In Colombia various decisions adopted by the National Monetary Board between 1967 and 1968 authorize the Banco de la República to receive advance foreign exchange returns on exports other than coffee; it also extends the time-limit for exchanging them into national currency, and lays down a special rate for such operations.

In March 1961 the Central Bank of Chile introduced a system whereby it acted through the commercial banks to buy the foreign exchange earned by exports during the period before reshipment.

One of the incentives provided by Paraguay's exchange policy consists in the Ministry of Finance <sup>17/</sup> granting partial or total exemption from charges on foreign exchange operations (which vary from 2.5 to 7.5 per cent of the f.o.b. value of the merchandise for certain exports such as tannin, sugar, canned meat, etc.). In addition, the National Economic Co-ordination Council may allow from 25 to 50 per cent of foreign exchange earnings to be retained abroad so that it will be available for the payments of dividends and profits to foreign investors if the country's payments position is not good enough for full payment to be made in the form of remittances.

In Uruguay earnings on exports of non-traditional items do not have to be exchanged at the official rate and are not subject to deductions (which is how the State syphons off part of the extra income produced by increased exports after a currency devaluation).

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<sup>16/</sup> Circular N° 136, 6 November 1964.

<sup>17/</sup> Decree N° 30085 of 22 July 1963.

(c) Fiscal incentives

In the last few years fiscal incentives have been used increasingly to promote industrial development. They take the form of various kinds of tax exemptions and of lowering tax rates. They apply to income tax, sales tax, the tax on net worth, land tax, taxes on profits, taxes payable on the agreements establishing enterprises, exemptions, refunds or compensations for taxes levied on the domestic market that have a direct or indirect effect upon exports, etc.

In Argentina and Mexico income tax exemptions appear to have had little effect on entrepreneurs' decisions to invest. Nor have they played an important part in other countries where taxes on manufacturing are low. As an instrument for promoting development this policy has not always had the desired effect; for example, in some countries the extension of fiscal incentives to all new enterprises without ranking them by order of importance, has resulted in excess capacity in certain branches; in others, the prolongation of the period for which the exemption was originally granted - after the new enterprises were making the normal level of profits which the incentive was intended to help the enterprise to attain when it was granted - has led to a waste of financial resources.

Provisions regarding tax incentives are generally found in various types of legal measures - usually connected with the income tax laws - or in special industrial development laws.

Promotional measures of this kind are to be found in: the law on the development of new and essential industries in Mexico (January 1955); law 3005 on industrial development in Ecuador (December 1964); the law on the promotion of industrial development (November 1959) and the general law on industries (July 1970) in Peru; the Legislative Decree on promotion, incentives and co-operation to encourage private investment in Bolivia (October 1963); and the promotion laws of Paraguay (1953 and 1955).

The most common way in which the countries encourage the establishment of new productive units, increase their production and promote export industries is through income-tax exemptions or deductions for limited periods. In cases where industries are declared to be of national interest and are given top priority in the national development plans, the exemption

may be total; the length of time for which the special treatment is granted varies, but is rarely more than ten years. In Mexico, income tax exemptions may not exceed 40 per cent of the amount payable under normal conditions.

Other tax incentives include cuts in sales and purchase taxes on locally produced inputs and intermediate products used in manufacturing.

In some countries, export firms may be granted tax incentives in the form of a refund of taxes paid on the domestic market which have a direct or indirect effect on export goods.

In an effort to increase sources of domestic financing on which enterprises can draw and to promote improved techniques, the countries of the region grant various fiscal incentives, which include the following: accelerated depreciation, tax exemptions on reinvested profits; revaluation of assets and the right to deduct certain amounts from the profits - subject to income tax (which may be the amounts used for direct capital investment, for the purchase of shares, for the replenishment of operating capital, etc.) such deductions are tax-free.

Measures under which the rate of depreciation may be increased according to the intensiveness with which the capital is used are specifically designed to allow more advantage to be taken of the depreciation funds maintained by manufacturing enterprises. These measures - which also have the indirect effect of encouraging more rapid replacement of machinery and equipment - mean that the volume of taxable profits is reduced, (since operating costs are increased by the increased cost of depreciation).

Further details regarding tax incentives and their application in various Latin American countries are given below.

In Argentina, fiscal incentives have been increasingly used as a means of promoting industrial development. Most of these are covered by Decree N° 3113/63 and apply to investment in specific sectors, such as iron and steel, petrochemicals, pulp and paper, or in certain regions, particularly Patagonia, the north-west and the north-east; the Decree empowers the National Development Council and the Central Bank to select industrial projects to be singled out for special treatment.

/Particular attention



Particular attention has been devoted to increasing the domestic sources of financing for industrial enterprises. A whole series of laws and regulations have been adopted in the last few years, all designed to increase depreciation reserves and ensure a higher rate of reinvestment of profits. The first step was to allow a certain percentage of the profits reinvested in movable goods and fixed assets to be deducted from income tax. Later on, in 1955, a special system, which is still in force, was introduced under which 100 per cent of the investment in machinery and equipment, 50 per cent of investment in movable goods and fixed assets, and 10 per cent of the cost of buildings used for productive purposes were deductible from income tax.

In Brazil, industrial development fiscal incentives are contained in a number of federal and state laws designed to develop specific branches of industry or certain regions. Most of the measures, including the more imaginative of them, are intended for the latter purpose, and for the most part provide for total or partial exemption from income tax for a period which varies according to the case. The criteria used for determining which industrial activities should benefit from these incentives also vary; but, generally speaking, industries of national interest that can help to solve the unemployment problem or that use the region's natural resources receive preference. This policy is particularly apparent in the measures adopted in respect of the north-east (articles 34/18 <sup>18/</sup>), which include a number of fiscal incentives to private investment.

There are also tax incentives of a more general nature designed to encourage capital formation or promote better techniques in industrial enterprises. Law 4357 of 1964, for example, provides for the compulsory revaluation of fixed assets in accordance with certain coefficients that are calculated each year. A special accelerated depreciation coefficient was also introduced in 1964 which is applicable to the purchase price of goods that depreciate in value (Decree N° 54298); with this coefficient, it is possible to calculate rates of depreciation to be deducted from gross profits.

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18/ Article 18 of Law 4239 of 27 July and article 34 of Law 3995 of 15 December 1961, with the regulations for their application contained in Decree N° 1166 of June 1962.

In Mexico, the Federal Government applies a number of fiscal incentives connected with depreciation, the reinvestment of profits and the revaluation of assets, but the most effective measures are undoubtedly those aimed at the promotion of certain selected categories of industry. The law on the development of new essential industries which superseded the law on processing industries in 1955, authorizes reductions of income tax, export taxes and of several other less important taxes that are listed in it.

Other significant tax incentives in Mexico include the subsidies granted by the President of the Republic through the Ministry of Finance and Public Credit - which consist of total or partial exemptions from any State taxes - which are largely complementary to the law on the promotion of new essential industries. They have mainly promoted the production of iron and steel, electrical appliances for industrial use, and balanced foods for poultry and livestock.

Lastly, in order to boost industrial activity in the area within their jurisdiction, the federal authorities apply industrial development laws under which exemptions for periods of up to thirty years may be granted.

In Colombia, tax incentives are granted to two types of industry:<sup>19/</sup> "basic industries" (i.e., those which use not less than 60 per cent of national raw materials and which have been dubbed essential or desirable by the Economic Policy and Planning Council); and "complementary industries to iron and steel" (i.e., industries in which at least 50 per cent in value of all the raw materials used are produced by Acerías Paz del Río). Exemptions are granted from income tax and from the supplementary tax on profits and wealth. The law also provides for a 15 per cent tax exemption on liquid profits used as reserves for the protection and recovery of assets. Enterprises are also authorized to apply an accelerated depreciation rate of 15 per cent a year instead of the usual 10 per cent, when their equipment is used for more than ten hours a day.

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<sup>19/</sup> Law N° 81 of 1960 and Decree N° 1391 of 1961.

Chile has various tax incentives to industry which are basically in line with regional development objectives and the promotion of reinvestment. The first is contained in Government Decree N° 375, which provides for reductions in income tax for new industries that are established outside the province of Santiago. The reductions are granted for ten-year periods and are between 20 and 60 per cent of the total tax, depending on the proportion of national raw materials used in production and on whether the industry concerned is new to the country or to the province. The second type of incentive takes the form of eliminating taxes on the profits used for capital formation by issuing stock or increasing the nominal value of shares.

Accelerated depreciation <sup>20/</sup> is also permitted at rates up to two and a half higher than those determined by the internal revenue service on the basis of the useful life of goods; but in no case may the accelerated rate exceed 20 per cent of the value of the depreciable asset. The President of the Republic, acting on advice supplied by CORFO, is responsible for deciding which industries may benefit by this system.

The legislation in force provides for other tax incentives, such as the revaluation of assets not counted as taxable income; <sup>21/</sup> income tax reductions for all enterprises that have operated without interruption for a period of five years and have increased their output by more than 10 per cent as a result of installing new plant or making alterations in existing plant; and the granting of exemptions from property tax on buildings or parts of buildings used to house industrial equipment.

In Peru, the main provisions of industrial tax policy are contained in the Law on the promotion of industrial development and in Law 9140 which supplements it by granting additional benefits. Both laws favour both new and existing industries. They exempt industry, for a period of fifteen years, from all taxes that directly affect production, with the exception of taxes on income and patents, stamp duties and consumption taxes. The use of profits for capital formation is also encouraged by granting tax exemptions on all profits reinvested in the same or subsidiary

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<sup>20/</sup> Decree N° 1 921 of 1964.

<sup>21/</sup> Law 15/564 of 1964.

enterprises (the proportion of profits so exempted depends mainly on the location of the industry and varies between 30 per cent, in the area of Lima and Callao, and 100 per cent in the Selva region). The two laws also empower industry to revalue machinery and equipment in national currency whenever the dollar value of the sol falls by more than 5 per cent. Some enterprises may qualify for the accelerated depreciation of equipment, depending on how it is used.

Apart from the above-mentioned incentives, there are special schemes under which exemptions are granted to promote activities in specific regions or industries in the interests of national development. For instance, the Law on stocks of industrial equipment makes various concessions to industries established in Arequipa, Tacna, Huancayo, Cuzco, Puno, Trujillo, Sullana and Chiclayo, and the law on the Selva area makes additional concessions to industries established there. There are various decrees that benefit specific branches of industry, such as canning, shipping, petrochemicals, chemicals and machinery manufacture.

In Venezuela, the taxes are fairly low compared with other countries of the region. This is perhaps why there are very few tax incentives to industry. Generally speaking, taxes on manufacturing are similar to those applied to other activities. The income tax law now in force, which was adopted on 17 February 1961, provides for rates of taxation on commercial and industrial profits ranging from 2.5 to 45 per cent, according to a sliding scale based on the amount of profits. Article 3 of this law empowers the Executive to grant total or partial income tax exemption to new industries that are considered to be important to the country's economic development, to industries established in specific regions and to export industries. The maximum period of exemption is ten years. Another article provides for compulsory investment of any profits in excess of 6 per cent of the capital and reserves of the enterprise.

The law on the promotion of industrial development in Ecuador provides for two types of incentive: general incentives (applicable to all existing and future industries except those of the artisan type); and specific

/incentives, applied

incentives, applied to three categories of enterprise: "special", "A" and "B".<sup>22/</sup> The following are some of the general incentives established by the above-mentioned law: (i) total exemption from fees, stamp duties and taxes applicable to the incorporation of companies, the issue or exchange of securities or shares, and working capital; (ii) the deduction of reinvested capital or fresh inflows of capital from profits subject to income tax.

The enterprises in the "special" category are exempt from all taxes and fiscal charges, both municipal and provincial, and, for the first five years of operation, they are exempt from 80 per cent of custom duties. Enterprises in categories A and B are exempt from 100 and 50 per cent of sales tax, respectively, for the first five years of operation, and are eligible for the accelerated depreciation scheme, with annual deductions of up to 20 per cent of the value of the investment.

In Bolivia, the system of incentives contained in the law on the promotion of private investment is aimed basically at strengthening the financial position of enterprises and decentralizing production. To achieve the first of these objectives, enterprises are granted 100, 50 and 30 per cent tax exemptions on profits that are reinvested to expand or diversify productive capacity, used for the purchase of shares in semi-public companies or Government bonds, or for the installation of new essential enterprises. The above scale is applied in descending order based on the proportion of the value of national raw materials in the total value of the finished product (more than 61 per cent, between 31 and 60 per cent, and less than 30 per cent, respectively). A system of accelerated depreciation may also be applied to the fixed assets of the

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<sup>22/</sup> Special category: enterprises considered to be of primary importance in the economic development of the country, which are granted special incentives.

Category A: enterprises that export at least 50 per cent of their output; produce raw materials or intermediate goods needed for domestic production; or produce goods that replace imports and therefore require high levels of investment.

Category B: enterprises whose activity is on the whole conducive to the country's development.

/investment projects

investment projects covered by that law (ten years for buildings and construction work, and five years for machinery, equipment, furniture and vehicles) in conjunction with tax-free revaluation of the fixed assets that have been depreciated, whenever there are variations in the exchange rate.

As regards the second objective, the above law grants reductions, over a period of ten years, in the tax on profits and in the consolidated supplementary tax of amounting to 100, 75 or 50 per cent according to the proportion of raw materials used by the enterprises which start operations in departments or regions that are marked out as development areas. This law applies equally to foreign and national investment.

Since the incentives provided for in the law are not granted specifically to manufacturing industry but in practice have a much wider scope, it has been the mining companies that have taken most advantage of it in recent years.

The system of incentives and the law itself are currently being revised.

In the Dominican Republic, tax incentives to industry are mainly in the form of exemption from duties on imports of machinery, equipment and raw materials and are granted equally to all branches of industry. A recently enacted law on the promotion of industrial development and incentives for it establishes additional tax incentives for export industries.

The income tax law <sup>23/</sup> provides incentives for those enterprises that reinvest a percentage of their profits, and exempts such profits from the usual tax, but it does not establish priority sectors for such investment.

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23/ Law 5 911 of 1962.



