PN-ABD-997
ISN-58343

International Science and Technology Institute, Inc.

DEVELOPMENT CONCESSIONS

IN BELIZE

Prepared for

Agency for International Development
USAID/Belize
(Contract No. PDC-0000-I-00-6134-00)
Work Order No. 22

Prepared by

International Science and Technology Institute, Inc.
1129 Twentieth Street, N.W.
Washington, D.C. 20036

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EXECUTIVE SUMMARY

This, study prepared by the International Science and Technology Institute, Inc., examines certain development concessions available to investors in Belize with a focus on concessions administered by the Ministry of Economic Development (MED). These concessions consist of duty exemptions on imported inputs and tax holidays. Other inducements to investment offered by the Belizean government were not the subject of the study, though they are noted where relevant.

Compared to other countries in the region, Belize does not appear to be at any obvious disadvantage in attracting investors on the basis of the concessions that can be offered. Currently, these concessions include tax holidays that can range from about two years to fifteen years, though the average is about five years. Duty exonerations may cover all imported inputs including capital goods and current production inputs, though they usually do not apply to fuels or spare parts. Duty exonerations are granted for the same time period as covered by the tax holiday.

The team found that the more effective concession is the duty exemption and that the tax holiday is of less value to investors. The duty exemption is important for export-oriented investors to maintain their competitiveness.

The MED appears to be efficiently administering the concessions as currently constituted. However, we have a few recommendations to improve the program. The following recommendations were made:

- -- Tax holidays should be more standardized with most being for a period of five years from the date of the first tax liability.
- -- Once a tax holiday is agreed upon, duty exemptions should be allowed almost automatically for inputs to production for export. Duty exemptions for inputs to domestic production should be subject to greater scrutiny.
- -- Tax holidays and duty exemptions need not be extended for the same time period. In fact, for exports, duty exemptions should be extended for an indefinite, period.
- -- Procedures for cancelling a concession for abuse or nonperformance should be strengthened, (as is occurring now).
- -- Concessions should be nonrenewable in all but extraordinary cases.

-- Duty exemptions should apply to spare parts and where administratively possible, to fuel.

-- There should be a minimal processing requirement for assembly operations aimed at the domestic market.

-- Information requested on the application should be simplified.

-- The processing time for applications should be accelerated through shortening the periods for soliciting views from the Ministries other than the MED and for the public comment period.

-- BEIPU should help investors process applications.

-- A nominal fee should be assessed by the government for processing applications.

I. INTRODUCTION

A. GENERAL

It is typical practice in developing countries to attempt to attract investment through offers of tax reductions, subsidies, infrastructure and other items. Although there are clearly many benefits to countries that are successful in attracting investments, the incentives offered can also be costly to the countries providing them. Often there are direct costs associated with subsidies or expenditure on infrastructure. More likely, most costs will be in the form of revenue losses from tax exemptions, though these are easily exaggerated since, without incentives, investment would surely be less than it is with them. In some cases, investments are not affected by the granting of concessions, and in these cases any concession is unnecessary and costly. Finally, indirect costs or benefits may accrue to a country offering investment incentives, depending upon whether there are associated changes in overall economic competitiveness as a result. Well constructed incentives can improve upon efficiency, though all too often, incentives cause distortions in economic signals which damage efficiency in the long run.

Belize is no exception to the norm. The principle incentives to investors in Belize are offered in the form of tax holidays and duty exemptions on imported goods under the Development Incentives and Fiscal Incentives Ordinances (Chapters 40 and 45, Laws of Belize, 1980). These are administered by the Ministry of Economic Development. Also, duty exemptions may be obtained from the Ministry of Finance, and under limited conditions, from the Controller of Customs. Investors can also gain protection from competition from imported substitutes from the Ministry of Trade, Commerce and Industry, which controls import licensing. Finally, land leases on favorable terms can be obtained from the Ministry of Natural Resources. Industries that are granted tax holidays can apply to the Central Bank of Belize to obtain convertible currency for the repatriation of profits and the remittances of earnings. Normally, if a concession is granted by the MED it includes a tax holiday and duty exemptions on imported building materials, vehicles, tools, appliances and other equipment, as well as on imported inputs for export-oriented investments. Duty exemptions are sometimes also offered on imported inputs for production aimed at the domestic market. Tax holidays may range from two years to ten years, though agricultural projects may benefit for up to fifteen years under the law. The tax holiday period seems to be entirely a judgment call by the MED.

B. FOCUS OF THE REPORT

This report focuses upon the development concessions administered by the Ministry of Economic Development (MED). The report also analyzes the likely impact of those concessions on the attitudes and behavior of investors in Belize; assesses the effect of concessions on the efficiency of the Belizean economy; and makes recommendations aimed at streamlining the concession-granting procedure and improving the overall investment climate. The report keeps in mind the country's revenue needs and development objectives. As we have pointed out, agencies other than the MED offer incentives. Therefore, whenever the report mentions the term "development concessions" we are referring to those concessions offered through the MED, which normally consist of a combination of tax holidays and duty exemptions.

It should be noted that much of the legal basis for development concessions in Belize has been discussed in a former A.I.D. project and will not be repeated here. (See: D. James, "Concession-Granting Process in Belize," June, 1986).

In making our assessment of the development concessions, and especially in making recommendations for improvement, several points must be noted. First, the team stayed within the terms of reference and focused on the incentives available through the MED. Therefore we did not explore other concessions such as the provision or construction of factory shells or the expansion of training programs. Secondly, we assumed that any changes in the kind of development concessions, or the way in which they are offered, should not imply great reductions in public revenues. Belize is under pressure to maintain and increase public revenues and we do not feel that recommendations that would reduce revenues are realistic.

The report first discusses the nature of the concessions as they currently exist and offers comments on procedures that are followed and the overall efficiency of the concession-granting process. It then discusses the impact of these concessions, taking into account the consideration of the theoretical impacts that concessions of various types can have and the likely impact that current concessions have in Belize. Finally, the report recommends modifications in the present program. Along the way several appendices dealing with related technical materials have been constructed.

II. CURRENT DEVELOPMENT CONCESSIONS

This section assesses the way in which development concessions are currently granted and also comments on the efficiency of this process. In our recommendations we support several actions which are already being taken by MED, and recommend concession characteristics which are much like existing ones. These statements endorse what is already a reasonably effective system. Although the current process now seems to offer reasonable incentives to investors, and MED staff appear to be handling the current concession-granting process well, we feel that the system can be improved upon. It is these improvements that we are after in this report.

A. PROCEDURES AND CRITERIA FOR GRANTING CONCESSIONS

Investors seeking a development concession in Belize must file an application with the MED. The application can take several forms, but must contain a standard set of information about the investor and the investment project. Information required in the application can be found in a document distributed by the MED, which is reproduced here as Appendix A. The information sought is largely determined by the requirements of the Development Law. The law requires that the extent of local activities, profitability, foreign exchange earnings or savings, and employment creation be reviewed. Many of the questions are drawn from the language of the legislation itself. The completed application materials can be submitted directly by the applicant, though many applicants avail themselves of the services of lawyers for this submission. Also, the Belize Export and Investment Promotion Unit (BEIPU) has recently begun to act as an intermediary in filing for development concessions.

The Ministry of Economic Development (MED) solicits detailed information from the applicant which it analyzes to determine whether the project is eligible for incentives. This information is also used to determine the scope and duration of the concession. Below is a summary of the information collected:

- -- Economic contributions to the economy, particularly employment;
- -- Financial sources and needs;
- -- Profit expectations; and
- -- Marketing information including details as to where the output will be sold and at what prices.

Some controversy surrounds the nature of the questions used to collect these details, since this information is not always available to investors during this start-up stage. For example, the application asks the investor to estimate "indirect" employment associated with the project. However, investors are not always in a position to make these estimates at an early stage. Thus, the information provided on this dimension is not always useful. Furthermore, the MED makes it clear that projects with favorable employment impacts will be viewed as more promising than others. If anything, there exists greater pressure to exaggerate the project's contribution to the economy, particularly the expected levels of employment. Questions concerning potential profitability are also critical since decisions about profitability are not in the appropriate domain of the government. Finally, the requested information may be so detailed as to be beyond the scope of the MED to verify and analyse given its level of resources.

Some of this discussion may be academic. However, since most of the detailed information is required by the legislation, the MED has little choice but to ask the questions. In fact, much of the language in the application is directly adapted from the legislation. Moreover, unsuccessful ventures often fail because of poor organization, financing, planning and sometimes even fraud. The MED argues that problems would be aggravated if such projects benefited from government incentives. Government support confers a certain legitimacy on a project and thus there must be careful analysis.

The MED also argues that the information is appropriate since most of the information is normally included in feasibility studies and other financial documentation. Most investors also make an attempt to investigate their potential market and assess the employment requirements to determine the profitability of the project. A good analyst can review the application and determine whether the employment estimates are usable. For example, if the figures on employment seem to be exaggerated, they can be compared to other companies already in operation. Secondly, it is doubtful that investors will attempt to overestimate potential employment since these estimates form part of the legal obligation of the concession, if granted. Hence, failure to achieve the target could provide grounds for premature revocation. Finally, the MED pointed out that questions relating to indirect employment are particularly relevant for projects where local contractors or growers provide inputs.

Other information requested directly effects the scope and duration of the project. For example, questions on projects that require duty exemption are necessary to learn what product exemptions will be required. Questions on when production will begin are important in order to assign the tax holiday. Finally, questions on locations are important to determining whether special regional incentives are required.

Projects are preferred if:

1. Minimum capital investment is BZ$100,000 for national ventures and BZ$200,000 for foreign ventures.

2. Minimum employment is 15 for national ventures (10 employees is acceptable if the investment is in a relatively underdeveloped part of the country) and 30 for foreign ventures.

3. A project should be profitable without concessions after a given period of time. The MED makes estimates of profitability where the applicant estimates are inadequate.

4. Projects should have a positive foreign exchange flow.

The team feels that the information requested in the application is in general both appropriate and required. However, some modifications could be made. For example, indirect employment questions should be limited to those cases where Belizean inputs are used. Also, some of the questions on the expected profit may be too detailed for just determining the beginning and ending periods for the tax holiday.

Upon receipt of an application, the MED summarizes the information contained in the application by noting the following:

1. Name of investor
2. Nature of enterprise
3. Amount and purpose of capital expenditure
4. Proportion of local value added
5. Estimated levels of exports
6. Amount of employment
7. Implementation timetable
8. Financing (amounts and sources)

The evaluation process also requires that the MED solicit the opinion of ministries most affected by the investment project. For example, if the investment project is to construct a new hotel, information on the project is forwarded to the Ministry of Commerce and Industry for comment. Projects dealing with the agricultural sector are forwarded to the Ministry of Agriculture. The implication of this step is that in the course of granting development concessions, the MED is supposed to reflect the sectoral priorities established by the ministries. This step complicates the decision to be made by the MED. In most cases, the comments that come back from the ministries are so unstructured and vague that they are of little use in elucidating the priority of the ministry or assisting the MED in its evaluation.

The MED makes a recommendation about what concessions should be considered after reviewing the information collected and the opinions of interested Ministries.

The evaluation involves subjective analysis by the MED, guided by the incentive law. There are few set tests and no formulas stating how the information is to be combined.

After review of the entire application, recommendations are made as to whether concessions should be granted, and what the concessions should consist of. The recommendations are appended to the summary sheet, and both are passed on to a cabinet sub-committee. The subcommittee is composed of the Ministers of Agriculture, Commerce, Industry and Tourism, and Economic Development. The subcommittee considers MED's recommendation and makes a recommendation of its own to the full cabinet, where final judgment is made. In practice, the MED has found that both the subcommittee and the cabinet almost always agree with the MED recommendation.

B. EFFICIENCY OF CONCESSION-GRANTING PROCESS

A brief examination of the criteria used to grant development concessions indicates several areas where problems might exist:

1. The projects are judged on a subjective basis. Other than a few guidelines concerning size and value-added, an investor does not know whether his investment will meet the criteria. More objective criteria would enable the investor to make better judgments. These criteria would ensure more consistency in the process.

   On the other hand, given the relatively small number of applications submitted, there appear to be no choice but to continue this method of evaluation. Objective measuring criteria, unless they are extremely complex with built-in weighted factors, are less likely to accurately reflect the desirability of projects than the subjective judgement of the MED examiner. Thus, it may not be feasible to construct such a weighted model, given the few applications each year.

2. There is unnecessary paperwork and follow-up for the MED staff, since much of the information solicited in the concession application cannot be used in an objective way and is of very limited use in deciding whether or not a concession is granted. Indeed, to obtain a full set of accurate and verifiable information on each project would not be practical given the resources of the MED. In the end, most concessions are very similar, and it would seem that the information required in the application could be reduced without changing the outcome of the procedure.

3. Applications by new investors seeking concessions for a venture are handled in the same manner as applications for renewals or extensions. The team questions whether this is appropriate. There are different assumptions concerning the two types of investments. Although worthy new investments should receive incentive packages, it is assumed that by the

time the concession expires, the project should be profitable without further concessions. Such concessions should only be extended if justified by unusual circumstances.

4. The minimum size criteria (in terms of total investment and employment) may discriminate against small investors, or in favor of relatively capital intensive operations. On the other hand, some minimum is necessary to prevent preoccupation with insignificant prospects.

5. Time delays occur at various stages in the project process. These delays do not seem to occur within the MED, but instead result partly from the requirement that projects be circulated through ministries for comment. Case studies reveal that as many as eight weeks (but typically 4-5 weeks) can be lost waiting for ministries to respond. Since their responses do not appear to be directly useful in making the concession decision, these delays appear to be very counterproductive. Delays also occur during the period required for public notice. After a concession is approved, but before a statutory instrument is issued, notice of the pending concession must be published in three consecutive weekly issues of Belizean newspapers and in two issues of the Government Gazette. One week is required after the last publication, to receive any objections from the public. This procedure takes about four weeks in total and MED personnel report that there is almost never any comment from the public. (There were only two comments in the past year). A further delay of about a week is associated with the need to publish the statutory instrument and receive an S.I. number, which is required by customs before any duty exemptions are honored. Finally, when an applicant is being represented by a lawyer, the MED often finds that communication with the investor takes much longer than it does when the investor is applying directly.

   In typical cases, the delay between application and granting of concessions may be 12 to 15 weeks. However, as much as 8 to 10 weeks of that delay are caused by the factors described above. Even if the process within the MED were streamlined (as we will suggest later) the delays described above will not be significantly shortened, since they are not usually associated with the MED's evaluation of the proposals.

   The team's concern over delays does not relate to the physical investments being held up. Instead, delays and what the investors may see as confusion, may give the signal that Belize is not receptive to investors which may weaken investor confidence. In general, while facilitating the application process, the MED should not be in the business of prejudging the viability of ventures that are selected by private businessmen.

6. Some questions on the application seem to seek information which is not necessary for the process. For example, investors usually do not have any reason to know the indirect employment effect of their projects. It is not information which is normally available to an investor, nor required for him to know in determining the profitability of the project. Also, other than general information on prospective prices, additional details may not be appropriate.

7. Concessions occasionally include duty exemptions for inputs into production destined for the domestic market. Given existing levels of tariffs in many areas, duty exemptions raise the level of effective protection for the production process in Belize to high levels. This could promote inefficient operations in Belize.

III. IMPACT OF DEVELOPMENT CONCESSIONS

A. USES OF DEVELOPMENT CONCESSIONS

Development concessions can be used for several purposes in addition to simply raising the profitability of investments. Public concessions to investors should not be used to attract investors into areas where market conditions would not permit efficient investments to be made otherwise. Official incentives to investors should be viewed as only of marginal importance in the investment decision. Ultimately, investors wish to earn a profit and, unless direct subsidies are offered, few development concessions can ensure profitability. Indeed, concessions should be seen as mechanisms to improve profitability without canceling the signals that investors would get from the markets in which they operate. Thus, incentives can be used in four main ways:

First, incentives can be used to improve competitiveness and efficiency of the production. In Belize, duty exemptions on imports are concessions of this type. In general, import duties cause a shift in relative prices favoring the production of non-tradable goods and import substitutes, and discriminating against the production of exportables. Duty exemptions can restore at least part of the bias against production for export and in so doing, improve upon the international competitiveness of Belizean exporters. Investors producing for the export market would be hard pressed to compete internationally if they were required to pay duties on their imported inputs.

Second, incentives can be used to demonstrate to investors that the government welcomes private investment. These incentives may not even benefit a company, but do send the right signal. For example, many investments may never benefit from income tax exemptions either due to the fact that under existing Belize tax law, they would not be liable to income taxes during the holiday period or their home country would tax the profit when repatriated. Yet offering such incentives demonstrates Belize's receptivity to investment.

Third, incentives can be used to improve Belize's attractiveness to foreign investors. Most incentives are designed to accomplish this. Appendix B illustrates what other CBI countries provide. Belize does not have the wide array of concessions that other countries provide. However, Belize's tax holiday concessions are comparable to other CBI countries. With respect to duty exemptions, Belize is less generous with concessions for export than many countries because it does not offer spare parts and fuel duty exemptions. Belize's comparative advantage seems to lie in industries that are land intensive or that rely upon the country's tourist attractions. Belize does not appear to have comparative advantages in labor intensive assembly operations because the country's labor force is rather small and wage rates high. Occasionally there will be an investor considering Belize as a location where concessions are important in the location decision. For the most part however, the level of concessions are not likely to influence greatly the decision to invest in Belize as opposed to elsewhere.

Fourth, concessions can be used to protect investors from some of the risks associated with their business. Examples of this type of concession might include loan guarantees, guarantees on prices, subsidized loans, etc. Currently Belize does not offer these concessions. One objection to concessions of this type is that they tend to be very expensive since they imply a direct cost to the country offering them, and, if they are successful in deflecting risk from the investor, they place the risk on the public sector.

B. CONCESSION TERMS

Concessions usually come at some cost to public revenues. Tax holidays imply a direct loss of revenue, though the actual lost in revenue is not clear. In Belize, the maximum period is ten years from the date of production, except in special areas where fifteen years is acceptable (agriculture). In most cases the early period of production for a new investment implies losses until full production levels are reached and the "learning curve" is overcome. During those early periods tax holidays do not imply any cost to public revenues since no tax liability would be incurred anyway. Also, tax holidays are of no value to investors under these circumstances.

Duty exonerations also imply a direct loss of public revenue. The exact amount of this loss is exaggerated by simply calculating the duties that would have been collected on the items that were imported duty free. Surely, if duties had to be paid on all items, fewer items would have been imported than when duty exonerations are offered. Similarly, one cannot argue that duty exonerations are costless to public treasuries since without exonerations nothing would be imported. Indeed, some imports will occur whether or not duties are charged. Thus, empirically it would be extremely difficult to estimate the revenue loss associated with duty exemptions.

The trick in managing the granting of concessions is to meet the objective sought by each concession while minimizing the cost to the treasury. Let us consider these objectives and costs for the two types of concessions offered in Belize.

Tax holidays are less powerful in stimulating investment than are duty exemptions. Whereas duty exemptions have their impact immediately by reducing investor costs, tax holidays provide an inducement by promising the possibility of future benefits. Thus, tax holidays only have an impact if and when the venture reaches a point where it is profitable enough to cause tax liability within the holiday period. Furthermore, tax holidays are a reward to the investor for having created a profitable venture, and do not affect the efficiency of the investment nor the efficiency of the economic system within which the investor operates. Most tax holidays are costless to the public sector in the first year or two after the project begins producing, but are also worthless to the investor since no tax liability is incurred anyway. After tax liability is incurred, the tax holiday makes a profitable venture more profitable.

How long a tax holiday is necessary to adequately reward the investor for creating a profitable venture? No one can answer this question with certainty. Investors will always want longer tax holidays since this will always increase their profits. In most cases, investments begin with losses in the early periods; over time however, losses eventually fall and profits begin to grow. With a tax holiday, profits grow faster. Eventually profits stabilize at their long run equilibrium level.

Since the tax holidays are offered before the investment is made, investors receiving them will view them as a means to boost their net profits more quickly once profits begin. As a result, the incentive to make the investment pay off quickly is rewarded by the tax holiday. One can argue that tax holidays provide greatest incentive when they cover the period when profits begin but before the long run profit level is reached. Once the long run profit level is reached, the investor is doing as well as he is able to do and no tax holiday can help him do better.

If the tax holiday is to be used as an investment incentive without unnecessarily imposing costs on the treasury, the tax holiday period should not extend beyond the time when the venture has matured to its "normal" operating and profit level. Most investments that are prudently managed will mature within a three to five year period. Exceptions would occur where projects have long gestation periods. This would argue for tax holidays that are about five years. For investments with long gestation periods the tax holiday should be extended to be long enough to allow companies about five years of tax relief from the commencement of profitability. Tax holidays that greatly exceed the five year effective periods are probably excessive since longer holidays impose costs on the treasury that probably exceed their value as incentives to investors.

Duty exemptions should be viewed differently depending upon whether we are looking at them from the point of view of the investor or the public policy maker (i.e., MED). On the one hand, the investor is interested in minimizing costs. Duties on imported equipment and inputs are just another cost of doing business and reduction of these duties serves to improve profit prospects.

On the other hand, the public policy maker should view duty exemptions differently. Duty exemptions should be viewed primarily as a means of making the economy function more efficiently. Policy makers know that duty concessions reduce costs and that making the concessions will attract businessmen who are interested in this incentive. But from a public policy perspective, the main impact that duty exemptions can have is to make the economy function more efficiently than it would otherwise Investors expecting to enter export markets would be at a great disadvantage in their international competitiveness if they were required to pay import duties on imported inputs and equipment. In the international markets where they hope to compete, their competitors, for the large part, operate free of duties on inputs. Thus, efficiency implies that Belizean investors in export activities should receive duty exemptions on imported inputs. One should note that this position stands independently of the impact that duty concessions have on promoting investment and is not associated with whether or not a tax holiday is offered.

Efficiency considerations dictate that duty concessions should be offered on imported inputs for production aimed at the domestic market only under strict conditions. Where there are duties on final goods, removal of duties on intermediate inputs raises the level of "effective protection" far beyond the level suggested by the duty on the final goods. Effective protection can become extreme, especially where domestic value added is small. This high effective protection promotes inefficiency, high domestic prices and poor quality. (Appendix C explains the concept of effective protection. It shows, by example, how duty exemptions on imported inputs for domestic production can raise effective protection to extremely high levels.) We therefore recommend that such concessions only be offered when there is a chance that the operation can become efficient and the duty concession will be terminated after a given period.

How much duty concession should be offered in Belize? Unfortunately, to answer that question one must confront the conflict between loss of revenue while gaining efficiency. Belize is still highly dependent on import duties for revenue, but the revenue so gained comes at a cost of reduced efficiency. Indeed, as most developing countries grow they normally shift away from taxes on trade and in favor of taxes that are less destructive of economic efficiency. From a purely economic standpoint, where efficient resource allocation is paramount, import duties should be relieved over time. All duties on imported inputs (capital and current inputs) to export-oriented production should be removed but in parallel with reduction of the duty on the final product. Furthermore, all duties on inputs used for production for the domestic market should be waived in only a few cases.

If production for the domestic market is to be promoted and protected it should be via import duties on final products. Protection should not be investor-specific. That is, the individual investor should not be protected by making him a monopolist (by withholding import licenses), nor should some individual investors receive duty exemptions simply to allow them to enter some line of production. Duties on final products are industry-wide. Thus, any investor who thinks that he can out compete others in that industry should be free to do so, and the most efficient producer(s) will survive. Ideally, tariff protection for an industry should be high enough to allow infant industries to get started, but should be temporary, so that infants are forced to "mature". Industry-wide, infant industry tariffs should reflect national development priorities and should not be established simply because an investor wishes to enter some specific line of production.

What is the revenue effect of the current program? Currently import duty collections run around $54 million annually (1986). If one assumes that all goods upon which duties have been exonerated due to development concessions would have been imported anyway, the loss of duty revenue on these items would be about $3.9 million, or 7% of the total (according to information provided by the Ministry of Finance). Clearly, some of the goods receiving duty exemptions would not have been imported without the exemption, so this figure is an overestimate of the proportion of duty revenue currently "lost" due to concessions as currently given. There are other regulations under which imported inputs are exonerated from duties. Current practice in granting development concessions, as reflected in a number of case studies, is to grant duty exemptions on almost all inputs to export-oriented production. Some duty exemptions are permitted on inputs destined for the domestic market. Increased emphasis on offering duty exemptions for export activities would have a very slight tendency to reduce revenues. However, to the extent that these exemptions fell on new ventures, current revenue would not fall, it would simply not rise as fast as it otherwise would. If duty exemptions were offered to export-oriented producers who are already active in Belize, the revenue depressing impact would be very small. Many if not most of these investors already have duty exemptions. Also, since current duty exemptions account for a very small proportion of total revenue, it would take a very large increase in duty exemptions on items currently subject to duty, to have a significant impact on overall revenue.

Finally, all development concessions should be subject to cancellation due to non-performance. Those investors who do not make the investment for which the concession was given, or who divert items brought in duty free under the concession to other uses, should be subject to immediate cancellation. In addition, projects that are abandoned should have concessions withdrawn. Finally, investors who do not file the information needed to monitor the concession program should also be subject to cancellation. Currently, cancellation is done on an ad hoc basis and at the discretion of the MED. In practice few concessions have been terminated for non-performance. During 1987, in reviewing the progress of investors with concessions, it was found that the MED had become much more active than in the past. Where necessary, the MED cancelled concessions for projects that had been abandoned or where concession terms had been violated. The MED has also recently increased its staff to accomplish this objective of enforcing the terms of the concessions.

C. GENERAL INVESTMENT CLIMATE

One of the most important investment promotion steps that the public sector can take is to make investors feel welcome. Investors, particularly foreign investors, respond very negatively to red tape, bureaucratic delay, or what might be viewed as public sector harassment. Foreign investors are attracted to frustration-free environments. While tax holidays and duty exemptions may help to attract investors, extensive red tape and delays in getting concessions may offset the attractiveness of the entire process. From the point of view of many investors bureaucratic delay and the frustration of dealing with a bureaucracy that does not understand their needs and interests are important reasons for deciding not to invest. Thus, it is very important that the development concession process reflect an attitude that one can do business in Belize without many impediments from the government.

The public sector in Belize must streamline its dealings with investors if it is to get across the message that Belize welcomes investment. Conversations with investors revealed little frustration with the MED. Nevertheless, the development concession granting process administered by the MED should be streamlined to help investors gain confidence that they will not be faced with many bureaucratic hurdles anywhere in the Belizean government. But this alone will not create a frustration-free investment climate. Many investors are discouraged by a number of bureaucratic problems that do not have to do with the granting of development concessions per se. If investors observations are largely true then the investment climate, as perceived by them, is not very favorable. To the investor it matters little if a part of the investment process is easy. It is the overall process that concerns them and causes their continue complaints about all bureaucracy.

D. IMPACT OF CURRENT CONCESSIONS

The above discussion can allow us to make several statements about the probable impact of development concessions as currently administered in Belize. These are:

1. Duty exemptions on imported equipment and inputs is the primary benefit currently offered. Many export-oriented businesses could not be competitive without this concession. Furthermore duty exemptions for export-oriented investments improves the overall efficiency of the economy.

2. Duty exemptions on imported inputs into production for the domestic market probably reduce the overall efficiency of the economy.

3. Tax holidays are of secondary importance in attracting investors.

4. Tax holidays are sometimes too long. There is little evidence or logic to suggest that tax holidays of ten to fifteen years do anything but improve investors profits.

5. The practice of renewing of tax holidays is not likely to have any efficiency effect. Furthermore, investors who claim to need continual tax holidays are in effect arguing that they are so inefficient that they could not exist otherwise. If they are that inefficient then overall inefficiency may be improved if they cease operation. Duty exemptions are different since they are needed to allow competitiveness in international markets. Thus, there are grounds for renewal of duty exemptions for export-oriented investors.

6. Duty exemptions on inputs to production for the local market, combined with limited licenses for importing competing goods is very destructive to economic efficiency. This is not a problem with the development concessions _per se_, since the granting of import licenses falls outside the development concession process.

7. The overall investment climate perceived by investors is probably more important in attracting investors than are the formal development concessions. Thus, the granting of concessions should be used as a signal to investors that Belize welcomes investors and that they will be treated reasonably by public officials. For example, prompt consideration and timely decisions on the applications for concessions sends a positive signal to potential investors.

IV. RELEVANT AND REASONABLE INCENTIVES

In our survey of the concessions offered to investors in Belize, we did not find problems with the kinds of incentives currently being offered. Duty exemptions are required in the Belizean context to ensure efficiency (i.e. their ability to compete) for investors aiming at the export market. Tax holidays provide a reward for having created a profitable venture.

A. RECOMMENDATIONS

To streamline the use of concessions we suggest the following steps:

1. Most tax holidays should be for five years. Tax holidays of ten to fifteen years seem unnecessary from either an efficiency or investment promotion perspective.

2. Consideration should be given to tying the beginning of the five year tax holiday to the date at which the investor begins to incur tax liability. Currently the tax holiday begins on the date of first production. Since investments have differing gestation periods, tax holidays of varying lengths have been offered. In early years many investments often incur losses, which can be carried forward. By tying the tax holiday to the date of first tax liability and providing it for the same period from that date forward the holiday will be worth about the same to all investors regardless of the gestation period. It would probably be unwise to leave the start of the tax holiday totally open-ended, so a limit might be placed on the latest date at which the holiday may begin. The holiday could be specified as beginning on the date of first tax liability or on a specified date, whichever occurs first.

3. Duty exemptions should be offered on all inputs (capital and current) into production for export markets. Current inputs into production for the domestic market should not receive duty exemptions, except under strict conditions.

4. Duty exemptions and tax holidays need not be tied to the same time period. We recommend a standard effective tax holiday of five years for most projects. Since we recommend duty exemptions mainly for export industries, and that recommendation is made on the basis of the efficiency needed in export activities, duty exemptions should be permanent as long as the enterprise produces for export. We recognize that this may require changes in the law governing development concessions and special monitoring activities. It is outside the scope of this study to recommend whether the permanent duty exemption should be under some type of drawback, free zone program or development incentives.

5. <u>Concessions should be "advertised" as a standard package</u>. That is, investors should be told if their application is approved they will receive an effective tax holiday and duty exemptions as described above. (This would be reflective of current practice.)

6. <u>The MED should clearly distinguish between the granting of development concessions and the granting of other concessions that the government may be able to make</u>. The development concessions are by definition the standard package of duty exemptions and the tax holiday. Investors may also want government to provide land leases, utilities, factory shells, etc. It should be made clear that the application for development concessions is separate from any other applications for these items. A single agency (possibly the MED) should be the conduit through which requests for permits and other applications are funneled to the other agencies.

7. <u>A development concession should be treated like a contract</u>. Under current policy, a development concession is legally binding since the application is a legal commitment signed by the applicant. The contract would specify what the investor must do to retain the concession. For example, it should constrain the investor to making the investment in the activity for which the concession was granted. It should also specify a reasonable timetable for making the investment. Finally, it should list specific violations that would lead to automatic cancellation of the concession. For example, it may specify that any resale of items brought into Belize duty-free under the concession is grounds for immediate cancellation. The list of contingencies and grounds for cancellation should be held to a minimum, including only those items which are critical to the effective management of the concessions. The threat of sanctions should not restrict the investor in making purely business judgments. Lastly, the contract terms should be adequately flexible to allow for unforeseen, but reasonable changes in the investment project.

8. <u>The standard development concessions should be nonrenewable</u>. That is, the streamlined treatment and standard concession package that we are suggesting should be offered only once. Frequently investors come to the MED as a concession is expiring and apply to have the concession extended. We believe that the standard concession package is adequate to promote investment and provide for efficient production. When investors come to the MED for renewals, they should be treated much differently than they were when they first applied. Grounds for renewal should be that there is some

extenuating circumstance why the first concession has not been adequate for the venture to prosper <u>and that extending the concession will allow it to eventually prosper without concessions</u>.

9. <u>Whether or not duty exemptions should be granted on fuel is a major policy question</u>. Theoretically, the argument that duty concessions are necessary to promote competitive export industries would also argue for duty concessions on fuel. If there were no institutional constraints we would recommend duty concessions on fuel as part of the standard package as we have for other productive inputs. However, in Belize there is great reluctance to allow duty-free importation of fuels because of the revenue impact and difficulty in monitoring. Unfortunately, fuel costs are high and some export-oriented projects are rather fuel intensive. We suggest that the appropriateness of fuel exemptions be looked at in each project.

   An alternative proposal could be to establish "industrial rates" for both duties on fuel and on electricity. Although this is outside of the scope of the study, it is included for illustrative purposes. Industrial duty rates on fuel which are lower than current rates could be offered as part of any concession. This would partially offset high fuel costs in Belize without giving up all revenue associated with fuel imports. An industrial rate for electricity, which is normal in most electric systems, would be a partial compensation to investors for high fuel costs. This industrial rate may have other benefits to the electrical system itself, though a full discussion of that would take us far beyond the scope of the current report. As with the diversion of inputs imported under duty exemptions, an investor who diverts fuel, purchased under an industrial rate, to another use, should lose all development concessions.

10. <u>Duty exemptions should be allowed on spare parts for export industries</u>. Again, the argument that duty concessions are needed for international competitiveness prevails. We recognize that controlling the end use of spare parts is a problem for the administration of concessions. However, spare parts are as much an input to production as other inputs and should be accorded the same treatment on efficiency grounds. Also, it may be important to note that many other countries offer duty-free entry for spare parts and Belize will be competing with them for both investors and in markets for final products. In any event, diversion of spare parts from their intended uses would be one of the grounds for concession cancellation.

11. A minimum domestic value added target is a reasonable concession requirement for investments aimed at the domestic market. In the past, many projects with extremely low value added and aiming at the domestic market have applied for concessions. Typically such projects simply repackage imported inputs or apply very limited processing to them. Most of these projects could not exist without substantial duties on competing imports and many even enjoy a monopoly position granted by limiting import licenses for competing goods. These projects also could not survive in a competitive environment and have little hope to become efficient. Nor do they offer much growth potential. Applying a minimum value added standard (e.g., 25%) should weed out projects with no hope for efficient production.

Value added minima for export industries should not be used. Unlike production in the domestic market, volume in export markets is unlimited. Thus, low value added does not preclude substantial export earnings.

12. Class Proposal for Dual Operators. Attention should be given to dealing with mixed enterprises, those which produce for domestic and export market. It is particularly important to devise a policy toward those investors who intend to export (and therefore receive concessions) but never do, as well as those investors who begin serving the domestic market, but who are able to move into exports.

An alternative which requires reporting of where the production is destined, is outlined in Appendix D. It is more complicated to monitor but would encourage non exporters to export. The proposed formula could also be used if a company, which was established to export, wanted to produce for the domestic market. Under our recommended concessions, this company would have no choice but to agree to revoking its incentive.

13. Accelerate the Process. Overall, the concession process can be accelerated. However, there is little that can be done to speed up the process where delays are a result of the investor's (or his agent's) failure to provide information in a timely way. A few improvements are possible in procedure which already is fairly efficient. Possible modifications include:

a. The MED should continue its current policy of informing applicants who come to it at the beginning of the period, of the possibilities of receiving concessions.

b. Throughout the review process the assumption should be that the applicant will receive concessions unless the investigation disqualifies them.

c. The MED should inform ministries of pending applications that might be of interest to them. The intention is to receive input from the ministries that would be useful in granting concessions on a timely basis. For example, the ministry should have one week to indicate whether it has any problem with an application. If it does not respond or if it indicates that it does not have a problem, the MED should proceed. If the ministry does indicate that a problem exists, then it should have up to two weeks to detail its concern.

   Ministries should provide the MED with a statement about the kinds of investments that should not be encouraged. Expressing priorities in this way gives maximum flexibility to investors to design their projects while simultaneously allowing some policy direction.

d. Finally, the period of public comment could be replaced by public notification early in the process.

14. Simplify the Application Form. Less information should be requested on the initial application to facilitate the research of the investor and the analysis of the MED. However, the scope for reducing information requirements is limited by statutory requirements for the MED analysis. Also, the government believes that it should verify the viability of the project. Even under these conditions, it is still possible to limit some of the information requested. We would suggest that the investor not be required to respond to questions on indirect employment except when there are direct linkages with other sectors and, in that case, he should identify the linkages, not the employment effect. An exception might be agricultural production where it is easier to determine how many suppliers will be needed. Also, detailed information on export pricing may be premature.

    If changes in the law were made, and the government was not as concerned about the viability of the project, less information could be requested. We have described minimal information required in such cases in Appendix E.

15. Standardized List of Imported Items. The development concession could be simplified by the formulation of a list of standardized inputs for specific types of projects. Currently, once a duty concession is in force, the investor must request permission to import specific items under the duty exemption. These requests are done for goods to be brought in for every six-month period, and are submitted to the MED for their approval. The MED checks the list and approves those items that appear to be required by the venture. In many cases, as a project develops, investors

may wish to import items that could not be foreseen at the project's outset and therefore were not listed on the original concession application. The MED must then decide whether or not the items are legitimately required by the project. Meanwhile, investors are uncertain as to whether duties will be exonerated and must wait until the MED makes a judgment.

To help improve this process, an inter-Ministerial group or the MED itself, possibly in consultation with the BEIPU (17 below) can develop lists of standard items which are so typical of each major industry that the MED could accept items on the list as automatically eligible for duty exemptions for investors in those industries. For example, the MED and the relevant ministry could work with the shrimp farming industry to come up with a list of standard items, both in kind and in quantity, that a normal shrimp farmer will need to develop a shrimp farming project. The MED should be willing to accept such a list (after negotiation) as automatically qualifying for duty exemptions for shrimp farmers with concessions. In this way shrimp farmers will know that certain items are automatically within their duty concession and that they can plan on importing them as needed. The MED workload would be reduced since staff would no longer have to deal with standard items. Although the MED would still have to deal with extraordinary items, this is done now in any event. It should be recognized that lists for every industry imaginable cannot be developed. However, when it appears that an industry is "up and coming" in Belize, and the MED can expect to deal with a number of investors in that industry, such a list may improve investor confidence and reduce the overall MED workload.

16. <u>Introduction of a Processing Charge</u>. It would be reasonable to support a MED proposal for the introduction of a nominal charge to cover the cost of processing, including the cost of publication in the National Gazette. This would also serve as a deterrent to frivolous applications. A nominal charge of $1,500 or $2,000 would be appropriate.

17. <u>The Belize Export and Investment Promotion Unit (BEIPU) can be an effective instrument for improving the investment climate in Belize</u>. BEIPU is already one of the first sources of information that investors encounter in Belize. Currently, BEIPU helps investors (for a fee) prepare their application for development concessions, and should continue to do so.

BEIPU should understand the distinction between the standard development concessions and the other licenses, permits, leases or special incentives that government may offer. BEIPU should also be available to represent investors before relevant government agencies in their applications for these items. BEIPU would act as an investor's agent in applying for these items, monitoring the progress of applications, filing requisite information and encouraging timely delivery of decisions on these matters. In preparation, BEIPU should learn exactly what information is needed by each step, what applications are necessary and design a system to monitor each case. BEIPU's services should be on a fee basis.

At one time there was some sentiment to shift the development concession granting process to BEIPU. This sentiment should be discouraged. BEIPU does, and should, represent and be an advocate for the private sector. Granting development concessions should be done with the public interest in mind and is therefore rightly performed by the public sector. Should BEIPU be involved directly in the decision-making process regarding concessions, its position as an advocate for the private sector would be weakened, for it would have to conform to some non-private sector interests. Furthermore, an attempt to shift the concession-granting process to BEIPU would generate some public sector resentment that would further weaken BEIPU's ability to represent investors before public institutions.

APPENDIX A

APPLICATION FOR A CONCESSION

Two Copies of Application to be Filed

(Note: A letter or memorandum may be attached to the application amplifying any point where it is considered necessary)

I	PRINCIPALS	Name and address of firm and major shareholders;
II	COMPANY FORMATION	i) Capital authorised and issued and affiliation to other firm (s)
		ii) Copy of Memorandum and Articles of Association to be submitted.
III	DESCRIPTION OF UNDERTAKING	Expected annual output at full production in quantity and value as well as the expected level of output at the end of the first year of production. The length of time it will take to reach the proposed level of operation.
		i) In the case of a manufacturing project, the articles to be manufactured, the manufacturing processes; type of machinery (new or used), drawing of plant.
		ii) In the case of agricultural project, the commodities to be produced and the acreage involved.
		iii) In the case of hotels and similar undertakings, the number and type of rooms, ancillary facilities, artist's conception of outlay and date of completion.
		iv) Date on which work on enterprise will commence and date product will be produced in marketable quantities.
IV	LOCATION	Location within the country and land tenure arrangements e.g. freehold, lease, hire/purchase.
V	MARKETS	Is production geared to the export and/or local market and in what proportion? In the case of export market the names of country(s) must be given. What are the proposed prices for product(s)? Mode of transportation to final outlet.

VI ECONOMIC BENEFITS

Contribution in specific economic terms which the undertaking is expected to make to the country's economy.

VII EMPLOYMENT

A. What is the expected employment at full capacity and at the end of the first year of operation?

(i) On persons to be employed:

(a) Directly
(b) Indirectly
(c) If it is intended to bring in technicians and other workers please state how many, the length of period of time they will work in the country and their field of specialization.

(ii) Conditions under which workers will be employed including housing arrangements.

VIII FINANCE

A. Give estimated requirements for:

(i) Fixed Assets:
Site
Site Developments
Buildings
Machinery & Equipment
Total Fixed Assets

(ii) Office Equipment

(iii) Working Capital

(iv) Organization Expenses

B. Indicate how it is invested by principals in the form of share capital stating the sources of these funds

(i) Amount to be provided by way of borrowing and from whom

C. Bankers reference to be given.

IX ROYALTIES OR OTHER PAYMENTS

Will any royalties, commissions, or fees be payable to external interests in connection with the project.

X PROFITABILITY

The following will be required :

(a) In case of expansion of existing enterprises, Audited Balance Sheets and Manufacturing, Trading and Profit and Loss Accounts of parent company for the latest five years, or

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(b) In case of new enterprises, Projected Profitability Statements for the new operation for each year up to and including the second year of full production. Estimated product costings supporting the figures given in the Profitability Statements together with actual costings for similar products made by the parent company should be attached.

(c) Cash-flow Statements (in a half-yearly basis) for the period up to the second year of full production.

(d) Projected Balance Sheets at the end of each year up to the second year of full production.

XI. CUSTOM DUTY EXEMPTION

(i) List and quantify the articles on which exemption is requested in respect of capital goods and equipment. Bill of quantities required for structures.

(ii) List of raw materials to be used in the processing and on which exemption from duty is requested.

XII. POLLUTION

Will there be any noxious effluent? If so, what arrangements will be made for its disposal and has the cost been included in the estimate of building costs.

I, on behalf of
apply for concession under the Development Incentives Ordinance, 1973.

I, on behalf of
certify the above information is correct in detail and, if granted a Development Order, I undertake to conform with the conditions of the Order and provisions of the Development Incentives Order, 1973 generally.

Name.................................

Date......................

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APPENDIX B

CARIBBEAN BASIN INVESTMENT INCENTIVES

Caribbean Basin Investment Incentives

Incentives to attract foreign investment are offered by virtually every country in the Caribbean Basin. These consist of fiscal incentives such as tax holidays and duty exemptions, the provision of industrial sites in free zones and industrial estates, special programs for featured sectors such as agriculture or tourism and a variety of bonus incentives such as training grants, tax rebates, cash rebates per worker employed and protective legislation against other imports.

While the region does contain anomalies such as the Cayman Islands with its complete freedom from taxation and Puerto Rico with its massive investment promotion budget and special U.S. tax situation, for the most part, Belize's competitor countries offer very similar incentives, at least on paper. Of the fifteen countries surveyed for the attached matrix, most provide the potential investor with tax holidays in the 10-15 year range; duty exemptions on most, if not all, inputs for production for export; factory space in industrial parks; relatively free repatriation of dividends and profits; and special incentive packages for tourism projects.

Of greater importance to the potential investor than the officially designated incentives, however, is the manner in which those incentives are processed, granted, reviewed and upheld. Even the most attractive incentives are useless if they are perceived to be slow in processing, arbitrary in granting, capricious in reviewing and unsecured by the local authorities. In addition, regulations and rulings outside the incentive programs may have a direct adverse effect on a project which may offset the benefits of the incentives. In the Cayman Islands, for example, the tax advantages are unparalleled, but a little-known board meets in camera to decide which resident permits will be granted and which will be revoked. The foreign investor has no say in the process and no means of finding out why a particular permit may have been revoked.

On the other hand, investors are favorably impressed with incentive mechanisms which are perceived to operate in a timely, effective and predictable manner. In Haiti, for example, the investment approval authorities could, through twenty years of experience, process an application for an electronics of textile project in 72 hours, provided the investor's paperwork was in order. This, coupled with Haiti low wage rates, made it the preeminent site for drawback operations for two decades and created over 60,000 jobs during that time.

While Belize needn't necessarily go beyond the incentives offered by its neighbors in the Basin, it should be aware of what they offer and either match them or make up for it by building a reputation for solid incentives offered to all investors, but administered and monitored in a professional manner.

CARIBBEAN BASIN INVESTMENT INCENTIVES

	TAXES	DUTIES	INDUSTRIAL PARKS	TOURISM	DIVIDENDS/PROFITS
ANTIGUA	Holiday based on value-added or enclave status. Range, 10-15 yrs.	Exemption for machinery, equip ment, raw materi- als and spare parts	Factory shells for lease. US$2.50 per sq.ft.	Duty exemption for material and equipment for hotel construction. Tax rebate for locally purchased items.	No restrictions on repatriation of pro fits or dividends.
ARUBA	No tax on profits from exports. 10 yr tax holiday for non export project	total duty exemption on equipment, raw materials, packaging materials.		2% corporate tax 11 yr exemption on income and occupancy tax. No import duties on materials or goods	No tax on dividend until 1999.
BARBADOS	Holiday based on value-added or enclave status. Range, 6-10 yrs.	Equipment, spares and raw materials duty free if not available in CARICOM	BIDC has nine ind- ustrial estates in operation. US $2.00 sq ft or lease pur- chase option.	Duty exemption for construction and op- eration of hotels. 10 yr license for duty and income tax exemption.	Repatriation of pro fits limited by gov erment formula. Divi dends to CARICOM residents tax exempt
BRITISH V.I.	10 yr tax holiday for approved pro- jects.	10 yr duty exemption.		10 yr income tax exemptionfor hotels. Duty exemption for construction material and equipment.	Free repatriation of dividends and profit
DOMINICA	Holiday based on value-added, en- clave or capital intensive status. Range 10-15 yrs	Tax exempt companies get duty free import of equip- ment, machinery, spare parts and raw materials	Factory shells avail- able. US $1.50 sq ft for first 3 yrs, in- creasing afterward.		Enclave industries may repatriate all profits. Others en- couraged to re-in vest a per centage.
GUATEMALA	10 yr holiday for exporters. 8-10 yr partial exemp- tion for rural in- vestment. Tax Credit Certificate for 10-15% for non- traditional export	For exporters, 1 yr duty exemption for materials and supplies. complete exemption on fuel oil. Full exemption on equipment, spares and accessories.		Full exemption from import duties, income taxes and certain other taxes.	

	TAXES	DUTIES	INDUSTRIAL PARKS	TOURISM	DIVIDENDS/PROFITS
ST KITTS	Holiday based on value-added or enclave status. Range, 10-15 yrs.	If qualified for tax holiday, no duty on equipment, spares, machinery and raw materials.	Two industrial estates offer factory shells at US $1.90-2.65 sq. ft.	10 yr. tax holiday for hotel of more than 30 rooms. Duty exemption for items needed for hotel construction and equiping	Free repatriation of dividends and profits
ST. LUCIA	Holiday based on value-added, enclave or capital-intensive status. Range, 10-15 yrs.	Duty exemption for length of tax holiday for machinery, equipment, spare parts and raw materials.	Factory space available at US $2.00-2.50 sq.ft.		Free repatriation of dividends and profits
ST.VINCENT	Holiday based on value-added, enclave or capital intensive status. Range, 10-15 yrs.	Duty exemption for length of tax holiday for machinery, equipment, spare parts and raw materials. Enclave operations may be granted an additional 5 yr. period for raw material import.	Factory space available at US $2.50-3.00 sq. ft.	10 yr. tax holiday and duty exemption on items for hotel construction and operation.	Free repatriation of dividends and profits
TRINIDAD & TOBAGO	Holiday based on value-added and enclave status. Range, 5-10yrs.	Rebates available on customs duties.(included with tax holiday)	10 industrial estates available.	10 yr. tax exemption and duty exemption on construction, maintenance and operation of hotels.	Dividends subject to withholding tax.Rate of repatriation of profits capital and interest regulated by the Central Bank and Ministry of Finance.

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	TAXES	DUTIES	INDUSTRIAL PARKS	TOURISM	DIVIDENDS/PROFITS
HAITI	Tax holidays are determined by location. All projects get 5 yrs, 3 more if located in industrial park, 10 more if outside Port-au-Prince. Further 5 yrs may also be granted for partial exemption	Full exemption on machinery, equipment, raw materials and accessories for exporters.	Industrial estate offers space at US $1.50 sq ft.		
HONDURAS	10 yr holiday for exports outside the Central American Common M[illegible]. No sales tax if 5[illegible] [illegible]onduran inputs used. Reimbursement on indirect taxes up to 15% for exporters	10 yr duty exemption onmachinery and equipment. 5 yr exemption of 80% on raw materials and packaging. 5 yr exemption on fuel duties.	Private export processing zones with free zone status available.	5 yr income tax exemption. 100% one-time duty exemption on materials and equipment for hotel construction.	
JAMAICA	Holiday based on value-added, enclave or capital-intensive status. Range 5-10 yr.	Approved companies get duty exemptions for machinery, equipment spare parts and raw materials.	Factory space in free zones available.		
MONTSERRAT	Holiday based on vale-added, enclave or capital-intensive status. Range 10-15 yr		Factory shells are available at US $1.40 sqft.	5 yr tax holiday on hotels. Complete duty exemption on materials and equipment for construction and operation.	No restrictions on repatriation of profits or dividends.
PANAMA	Total exemption for exporters from all taxes except real estate.	total duty exemption for exporters on raw materials, equipment and machinery, spare parts, intermediate products and packaging elements.	Large free zone and 12 "develcpment areas" offer factory space and special incentives.	13 yr income tax holiday. Total duty exemption for projects in "special tourist zone".	

APPENDIX C

EFFECTIVE PROTECTION

Appendix C

Effective Protection

The concept of effective protection focuses on the fact that in many import-substitution industries, final goods are produced from imported inputs and yet tariffs are charged on the entire final good (<u>including</u> its inputs). The tariff protection does not protect the production of inputs which are imported, but only that proportion of production that is done domestically. Since production in the international market is also done by combining inputs which are tradable, the proper way to determine what the level of protection is to compare domestic value added with international value added for the same operation. The latter is the closest thing possible to a "free market" alternative to domestic production. Effective protection is defined as the percentage by which domestic value added exceeds international value added for a give process. (For details on the concept see: B. Balassa, et. al. THE STRUCTURE OF PROTECTION IN DEVELOPING COUNTRIES, The Johns Hopkins Press, Baltimore, 1971)

Some numerical examples should make the concept clear. Suppose there is some good, A, which is available internationally at a price of $200. Suppose further that good A is produced from three inputs, X, Y, and Z, and that these inputs can be purchased internationally for $50, $30 and $100 respectively. Total input cost is $180. Thus, in international markets, producers combining X, Y and Z into good A create value added of $20. (Value added in the production of A from the inputs X, Y and Z, is the final value of the inputs.)

Consider a developing country which decides to engage in import substitution for good A, by importing X, Y and Z, combining them into good A domestically. Assume that a 50% tariff is placed on A and the inputs X, Y and Z. The 50% tariff raises the imported cost of good A to $300 and the cost of the inputs to $75, $45 and $150 for X, Y and Z respectively. Thus, the cost of inputs totals $270. Domestic value added, which is the price received for the final good minus the cost of imported inputs is $30. Effective protection on the portion of production carried out domestically is 50%. (i.e., domestic value added divided by international value added or $30/$20 converted to a percentage).

Now suppose that in the same country, the producers of good A receive a duty exemption on the imported inputs X, Y and Z. Good A is still protected by the 50% tariff and sells for $300 in the domestic market. But now the imported inputs cost producers only $180. Thus, domestic value added is $120 and the effective rate of protection on the portion of production carried out in the country is 600% (i.e., $120/$20, converted to a percentage.)

In general, if both inputs and outputs are protected by the same level of tariffs then the effective rate of protection will be equal to the nominal rate of tariff on the final good (as it was in the first example). If rates of tariffs on imported inputs are less than they are on final goods then the effective rate of protection on production of the final good will exceed the nominal rate on the final good. (As occurred in the second example). Also, the smaller the domestic value added relative to the value of the final product, the higher the level of effective rate of protection is relative to the nominal rate. Finally, the greater the gap between the duty on imported inputs and the duty on final goods, the greater will be the difference between effective protection and nominal protection.

In Belize, effective protection on the production of import substitutes is likely to be much greater than the nominal rate of protection on final goods. In general, Belize's tariff structure levies lower tariffs on inputs than it does on final products. Thus, effective rates of protection will exceed nominal rates on final goods. Typical proportions in Belize might be such that final good A might carry duties of around 30%. If we stick with the example given above, A would sell for $300 while the inputs would cost producers $234, yielding a domestic value added of $66. Thus, effective protection on domestic production is 330%, (i.e., $66/$20 expressed as a percentage). In Belize there tends to be very low value added in import-substitution production and therefore effective protection is likely to greatly exceed nominal protection. If duty exemptions are given on imported inputs, effective protection is higher yet.

It is possible for effective protection to be negative when the tariff rates on imported inputs exceed the nominal rate on final products. In the example used above, if the tariff rate on the imported inputs, X, Y and Z were 70% then imported inputs would cost producers $306 while the imported final good cost only $300, and domestic value added would be negative. No one would choose to produce under these conditions and import substitution would be impossible. If a policy choice were made to engage in import substitution for good A, then either duty exemptions would have to be offered on the imported inputs or the entire duty schedule revised.

APPENDIX D

MIXED ENTERPRISES

ENTERPRISES WHICH EXPORT AND PRODUCE FOR DOMESTIC MARKET

Mixed Enterprises
Enterprises which Export and Produce for Domestic Market

It would be easy to offer duty-free entry of inputs for exporters while duties are charged for inputs to domestic production if all producers are clearly in one activity or the other. However, some investors are in both. Frequently, the business plan of an investor is to begin production for the domestic market, then enter export markets as the operation becomes more efficient. Unfortunately, too many of these never get beyond serving the domestic market. Since the concession is given before an export track record is established, full duty concessions may be granted to an investor who, in the end, never exports. Thus, some mechanism must be devised to adjust the duty concession when exports do not materialize. No adjustment mechanism is perfect since most decision rules would either penalize export efficiency or overly protect domestic production.

One solution might be to require a review of export performance, at say the third year and every two years thereafter. Recall that we are recommending a permanent duty exemption for export activities. If a firm shows export promise it could receive full duty exemption at first. After three years, export performance could be reviewed. If a large proportion of production (say 80%) is exported the duty concession can stay in force. If less is exported then duty concessions in the future would be scaled back proportionally. Alternatively, as a sustained incentive to export, duty concessions may be cut back slightly less than the percentage by which firms miss the export market. For example, let us assume that we have set the point at which a firm begins to lose duty exemptions is when it falls short of exporting 80% of its output. Suppose we examine a firm and find that it exports only 60% of its output. Since the firm has come 75% of the way toward meeting the export goal (60% / 80%) its duty exemption could be cut by 25%. In this way exports count slightly more than domestic production in reducing the overall duty payment.

There is a cost involved in this procedure. In giving a slight incentive for exporting we simultaneously give a bit of overprotection to domestic production. In the above example exports were 60% but the duty concession was 75%. Thus, there is a 15% duty reduction that goes toward increasing effective protection in the domestic market. Fortunately, the further the producer gets from meeting the 80% target, the smaller is the proportional impact on effective protection in the domestic market. For example, if the producer only exported 10% of his output then he would have come only 12.5% of the way toward meeting the 80% target. His duty exemption would be cut by 87.5%. Thus, only 2.5% of the duty reduction goes toward increasing effective protection. Indeed, the duty reduction is close to what it would be if duties were simply cut in direct proportion to exports. (With direct proportional cuts 10% exports would be associated with 90% duty exemption cuts). The main thrust of the scheme presented is to stimulate exports without implying any large increase in effective protection.

The above discussion is concerned with the investor who is originally classified as an exporter but who ends up producing in the domestic market. The reverse condition could occur where an investor is originally in the domestic market and therefore does not receive duty exemptions, but who nevertheless becomes able to export. To retain duties on his imported inputs would put the producer at a great disadvantage in international markets. Therefore, a mechanism should be devised to introduce duty exemptions as the producer enters export markets.

A duty rebate system, based upon export performance, would allow investors in the domestic market to enter export markets. The rebates could be structured so that the investors could count on them in setting their export prices. That is, in setting prices for export, each producer would take into account the duty rebate that would be forthcoming for any successful export transaction. The rebates could be structured to give a little extra incentive to exporting. Following the example above, where a producer qualifies for full duty exemption if he exports 80% of his production, if a producer without a duty concession can export 10% of his output then he is 12.5% of the way toward qualifying for a full exemption. (10% / 80%) Thus, his duty rebate would be for 12.5% of duties paid.

It is important that the rule for cutting duty exemptions and the rule for duty rebates be the same. That is, the rule for cutting the duty exemptions for investors who fail to export should be the mirror image of the rule by which duties are rebated to producers in the domestic market who are able to export. In this way the same incentive applies to both kinds of investors. In the numerical example given above the rule for adjusting rebates is the same no matter the direction in which the duty is being adjusted.

APPENDIX E

MINIMAL INFORMATION REQUIRED FROM APPLICANT FOR CONCESSION

Appendix E

Minimal Information Required from Applicant for Concession

The criteria used to determine which investors receive development concessions could be simplified if there was a legislative change. We are not recommending this change since we do not know how receptive Belize is to reopening this question or what the political consequences of such a change would be on other aspects of the law.

Criteria should be kept to a minimum. The criteria should focus first on whether or not the applicant is honest and has a reasonable reputation in his business dealings and second, on whether the project fits into Belize's development priorities. Criteria which could be used include:

1. Business references. Business references should be required of each applicant and should be checked out by MED. Bank references are important. Furthermore, the investor should be willing to pay the cost of this evaluation. In the past a fee has been discussed which would cover the application processing costs, including the costs of a credit and general reference check. It is appropriate to charge such a fee. The amount of any fee should be set by MED upon determination of what the processing costs.

2. Value added. A value added target should be set for producers in the domestic market who are engaged in assembly operations. We are not suggesting a mathematical calculation but more of an indication of the production process which will be carried out in the country. Investors should provide a detailed a description of their production process along with supporting materials. Investors for export should not be subject to value added minima. Value added is particularly unimportant in the export market since volume there is potentially unlimited.

3. Does the investment fit Belize's development priorities? Priorities should be specified as areas in which investment should be discouraged rather than as areas for encouragement. For example, the Ministry of Tourism may decide that there should be no special encouragement given for investments in building timesharing condominiums or for hotel in San Pedro. Thus, any project in these fields would automatically not qualify for concessions. The reason for stating priorities in this exclusive way is so that projects that no one has ever thought of before are automatically included. Furthermore, since we are recommending a standard concession package, all approved applicants will receive the same incentives no matter what the project.

4. Sources of financing should be considered. The question should be asked, if the project fails, who bears the foreign exchange costs? In the case where there is no foreign exchange costs to Belize (as in cases where investment capital comes from abroad) there is little cost in giving a concession. Where capital is raised in Belize and used to import inputs there would a foreign exchange cost to Belize in the event of failure.

   With investors who plan to export, it is reasonable that some foreign exchange risk occur, since the objective is to eventually earn foreign exchange. Thus, despite foreign exchange risk, the standard package of duty exemptions and tax holidays should be offered. Investors in the domestic market should be encouraged to not risk foreign exchange. There are two alternatives that might be used to do this. First, if the capital for the investment for production in the local market comes from local capital which has to be converted to U.S. dollars (or any other hard currency) to import capital goods, there is a foreign exchange risk. Thus, the tax holiday might be withheld as a penalty for risking Belize's hard currency. Second, a more positive approach might be to reward local investors who can obtain their capital abroad. If a local investor can borrow abroad, and the venture fails, it is the foreign lender who loses the hard currency, not Belize. Investors who are able to obtain their capital abroad may be "rewarded' with duty concessions on the capital goods that they import. Of the two approaches we prefer the latter.