Fulbright School of Public Policy and Management

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INTRODUCTION TO PUBLIC POLICY

POLICY MEMO SAMPLE

POLICY MEMO

Re: Do We Need an Industrial Policy?

I'm writing to provide some inputs for the coming meeting with the Ministry of Industry and Trade (MOIT) and the World Bank on the suggested tax incentive measures to promote the domestic garment industry. At this point of time, it is difficult for us, the Ministry of Finance, to objectively analyze this proposal without further information. I, therefore, put forward the following questions that we can ask MIT and the World Bank. Based on the responses, a more effective course of actions can be formulated.

1. Questions for the Ministry of Industry & Trade (from the recent survey of garment firms)

a. In the survey, do firms tend to grow over time and established firms enjoy significant reduction in production costs?

b. Do firms have easy access to knowledge (i.e. design, technological, and marketing information) which is generated overtime by other firms in the industry, and if yes, how?

(i) Do they get knowledge mainly from workers who frequently move from one firm to another? Do the firms experience a high rate of worker turnover?

(ii) Or do the firms get information about design and costs by directly observing and copying with ease from their competitors?

c. Do garment firms face shortages in skilled labor such as designers and marketing professionals? How adequate are the practical training facilities in terms of quantity and quality?

d. Do garment firms obtain sewing machines and textiles from local firms or from imports? Regarding technologies, textiles, and machinery that cannot be produced locally, can garment firms obtain them competitively in the international market?

e. Are garment firms with good business plans able to obtain loans from financial institutions?

f. Do garment firms have access to infrastructure services such as electricity, communication and transportation, and marketing and procurement services?

g. How often do garment firms participate in international trade fairs and receive visiting missions from buyers?

2. Questions for the World Bank

a. Given the Bank's work and experience in our country and others, what are the main obstacles created by existing government polices towards the garment industry?

(i) Do existing regulations make it difficult for the establishment of new firms?

(ii) Does the existing export quota distribution discriminate against private firms?

b. How competitive are the costs of infrastructures such as electricity, communication, and shipping compared to those in other countries which are major garment producers?

c. What is the estimated loss in tax revenue if the suggested tax incentive measures are implemented? What will be the adverse impact of this tax loss on other sectors?

d. How much burden will the tax incentive scheme put on tax administration?

e. How does the Bank think of the answers of MIT to the questions in (1)?

3. Suggested Course of Actions

Giving tax breaks to the garment industry means reduced tax revenue, i.e. other sectors are taxed more. This is justified only if some markets in garment production are failing, and intervention will generate benefits that outweigh the loss in tax revenue.

Firstly, we have to identify our own policy shortcomings. Getting the objective opinion of the World Bank in this regard is very important. If garment entrepreneurs have to face lengthy delay to get a business license, or discrimination in export quotas or tax and customs harassment, eliminating these policy-induced distortions should be done.

If the responses we get suggest that a favorable business environment is enough to raise the private profitability of garment production, then policy intervention such as tax breaks would lead to unnecessary loss in tax revenue like the World Bank's claim.

On the other hand, the government has to take an active role when (i) the industry needs literate workforce to produce at low cost, (ii) its firms accumulate knowledge and reduce costs by expanding production overtime, and (iii) its materials and machinery cannot be obtained perfectly from international markets. However, we need to determine the specific problems that block growth in the industry so that it can be addressed directly.

When firms are reluctant to invest in sewing and supervisor training because employees leave for little increase in salary, the government can directly subsidize this activity. It can provide support in organizing trade fairs and promoting trade associations to help firms getting information and developing their marketing and design capability.

Even if entrepreneurs can obtain the full benefits of know-how created overtime, but they lack access to the capital market then investment will not be realized. Changing the current bias of directing credit to heavy industries will help. In addition, government intervention should be in developing long-term financial institutions such as securities market, finance companies, and leasing firms.

The responses may also reveal that entrepreneurs are not willing to make investments because there are so few local firms. As a result, marketing, procurement, and infrastructure services are missing, which in turn make garment production costly and unprofitable. Hence, the government has a case to coordinate investment. A three-year corporate income tax holiday for firm and a tax break for firms making new investments can raise the level of profitability and break this low-investment vicious circle.

The government can coordinate investment by subsidizing the construction of industrial parks for garment firms. It is very hard to make efficient infrastructure such as electricity, communication cables, and ports for the whole economy overnight. However, concentrated industrial parks can be established with complete infrastructure services. This will also make it profitable for training, research, design, marketing, and procurement services to cluster around these parks. This type of intervention is also superior to the tax breaks if the current tax system is already complicated and the tax authorities are lacking management capability.

Finally, the above interventions which are intended to promote new investment need to be complemented by measures to eliminate unproductive firms and rent seeking. Export quota distribution based on export performance is recommended. As quotas are being phased out, subsidies in training and services in industrial parks (e.g. reduced rents) can be made contingent on export performance.