ISE

Citizen-Centered Approaches
to State and Market

Economic Tools Mapping

SPECIAL ECONOMIC ZONES (SEZs)

Market Building Initiative: A Program with the Aspen Institute

Institute for State Effectiveness

600 New Hampshire Ave NW
Suite 900
Washington DC 20037

+1 (202) 298-5959
info@effectivestates.org

Economic Tools Mapping
Special Economic Zones (SEZs)

Market Building Initiative
A Program with The Aspen Institute

Overview

Special economic zones (SEZs) have increased in popularity over the past 2-3 decades as a tool for developing countries to attract increased commercial presence. Though they exist in a variety of forms, special economic zones are designated areas within a nation that possess more liberal economic regimes than the country as a whole and aim to attract foreign commercial investment through a reduction in tax rates, tariffs, and other regulations raising the cost of doing business. Countries are looking to the establishment of these areas of more open market regimes as providing a variety of benefits in diverse areas including increased FDI, regional development, technology transfer, foreign exchange income, and employment. Other, less tangible benefits for developing countries include business climate reputation, export-orientation, bureaucratic performance, and the ability to experiment with increased trade openness and liberalization policy in a controlled setting. Standards for human rights, labor conditions, and environmental impact may or may not be higher and well-enforced in these areas. Connecting the citizens and industries of developing countries with the multinational private sector through the government's decrease in taxation and provision of favorable conditions for commerce can have extended developmental effects.

It is important to note that these potential benefits of special economic zones may not be substantial for certain economies and the benefits and costs must be weighed in a customized manner for each country. For a relatively open economy with low taxation, good labor relations, liberal markets, overvalued currency or price-insensitive exports, and certain geographies, the advantages of a special economic zone may not be worth the effort of establishment. In some places in East Asia, it has been shown that there was a continuation of low-wage jobs, rapid turnover of firms, low levels of broader investment, and persistent subsidy, undermining potential gains. Feasibility studies and extensive cost benefit analyses of the proposed kinds of economic zones should be conducted on a case-by-case basis.

Structure

Special Economic Zones vary in form and by country but are present in developed (United States) and developing (India) countries alike.

SEZs use a variety of institutional structures to establish and administer the areas:

- Public- government operator, government developer, government regulator
- Private- private operator, private developer, public regulator
- Middle Ground- public sector operators and developers as quasi-government agencies with corporate structures, budgetary autonomy
- PPPs- often structured so that the public sector provides infrastructure, equity, soft loans, bonds issuance while the private sector fulfills functions obtaining a reasonable rate of return on development investment

Some SEZs contain multiple specific zones within one economic area, generally broken down by the good or service produced, for example, textiles or chemicals. They often offer high-quality transportation, communication, real estate, and services infrastructure along with one-stop-shop windows for business services such as registration and licensing. The rules for operation and taxation on these businesses vary, but are generally quite lenient.

An elaboration on the various arrangements SEZs can operate within can be found in Box 2.

Rules

The legal frameworks- on establishment, operation, taxation, trade, environmental impact, and labor and human rights- vary depending on national conditions and objectives. Generally speaking, SEZ legal frameworks provide duty free conditions for import, domestic procurement, and operations and maintenance. Ownership requirements are generally lax, often businesses are allowed to be 100% foreign owned. So long as the inputs for products are exported, investors face no customs, taxes, or restrictions.[1] Sales within the country, outside of the SEZ would then be taxed as standard imports, in most cases. Income tax, sales tax, service tax, and other taxes may be completely waived for businesses within these zones, back-loaded, or increased only gradually after a few years. There may or may not be requirements on foreign ownership. Repatriation of profits is also generally unrestricted. Governments may or may not provide expedited establishment and procedural access for businesses within a SEZ (such as one-stop-shops or single windows) for functions like clearance or approvals.[2]

Financing

As there are a variety of financing structures for SEZs and they can be foreign funded, publically funded, parastatal, privately funded, or cost-sharing. [3] The actual construction costs, if there are any, can be quite expensive depending upon the amount and quality of infrastructure needed, such as roads, building space, utilities infrastructure, manufacturing facilities, security, and air and sea transport. The government or a developer may be entrusted to plan and execute the construction of the zone itself. Management can be quite extensive and include licensing and tax administration, security provision, leasing and facilities tasks, utilities provision, transportation logistics, and various other services. Some of these tasks, licensing and taxation, for example, are necessarily government-interfacing, though private companies may be charged with their administration. The financing structure for establishment and management of SEZs is, as it should be, customized across countries based on the needs of the government and foreign investors.

An often underemphasized cost of SEZs is the sometimes indirect supporting infrastructure. Municipal water, sewage, telecommunication, and energy systems within the surrounding regions may require upgrade. Airports and roads in surrounding areas may need to be constructed. Rule of law and security for adjoining areas might also be cost increasing for the government. Housing and other services for migrating labor in adjacent areas is another such consideration. While these may not be part of the SEZ costs proper, they are burdens faced by the government in creating preconditions for successful operation.

Operations and Outcomes

[1] Nigeria allows sale of up to 25% of products within the domestic market as a means of offering product access for merchants and citizens

[2] Special Economic Zones in India, managed by the Ministry of Commerce and Industry, offer this benefit as one of many examples, for more see: http://www.sezindia.nic.in/about-fi.asp

[3] Zambia has two SEZs primarily supported by the Chinese government, the Philippines utilizes domestic government authority, Russia has a specific state-owned industry for the function, Nigeria's Lekki Zone is managed by a Singaporean private holding company

Special Economic Zones can encourage industrial production and employment, banking and investment, commercial research, interest in domestic goods and services. They allow for governments to concentrate the costs of FDI attraction and offer comprehensive packaging that can overcome investment climate reputations and make necessary regulation and oversight more efficient. There is evidence that establishment of these zones is trade enhancing.[4] These zones can also increase foreign exchange earnings which can be beneficial for nations which have debt denominated in other currencies. They may have a diffusion of international standards for business practices, accounting, and human rights and environmental practices. Tech transfer and exposure of labor and business may result in human capital gains. Increased product access, local industry linkages, and government revenue may also come about. Linkage industries in particular can face increased exposure and income. While evidence of benefit varies from country- to- to country, many nations have found that SEZs are an extremely cost-effective way for the government to create jobs.[5]

Gains are neither guaranteed nor universal and may draw resources away from local businesses, give undue privilege to foreigners, or undermine investment in local economies. Ensuring the correct preconditions are present and that SEZs are part of a larger and comprehensive plan for economic development is key to success.

Box 1- Jebel Ali Free Zone (علي جبل في الحرّة المنطقة)

The Jebel Ali Free Zone in Dubai is one of the most successful SEZs globally and the fastest growing, offering superior logistics and real estate to businesses in a convenient location for sourcing goods for transport to Africa and other locations. Led by an innovative and client-oriented female CEO, Salma Ali Saif bin Hareb, the zone continues to offer innovative product offerings for businesses. At over 18 square miles of purpose-built facilities, Jafza presents an attractive location. Founded in 1985, the zone has expanded to include light manufacturing as well as more specific industrial areas for various types of industry. Lipton, Lockheed Martin, Bayer, and GE have chosen to locate in this zone. Emirati legal frameworks provide for 100% foreign ownership, no customs duties, no income or corporate tax, no labor and currency restrictions, and one-stop-shops for government services. Jafza has grown its customer base by 60%, increased its own revenue by 34% on average year-to-year, and has accounted for over half of all of Dubai's exports. Perhaps more importantly, Jafza has contributed to Dubai's GDP by 25% year-to-year, sustained over 160,000 jobs in the UAE via companies utilizing Jafza, and has accounted for 20% of national FDI inflows.

See: http://www.jafza.ae/

[4] Wei Ge, "The Dynamics of Export Processing Zones." December, 1999, UNCTAD/OSG/DP/144
[5] Rubin, Barry M., Margaret G. Wilder, "Urban Enterprize Zones: Employment Impacts and Fiscal Incentives." *Journal of the American Planning Association,* Autumn 1989.

Box 2- SEZ Arrangements
SEZs utilize varying forms depending on the geography, purpose, and objectives within the area:

- Urban Enterprise Zone- UEZs encourage development in blighted neighborhoods through tax and regulatory relief, often at the national and sub-national level, to entrepreneurs and investors who establish businesses
- Industrial Park- also known as industrial estate or trading estate is an area for the purposes of industrial production next to key infrastructure and sometimes with reduced taxation or other government benefits
- Free Trade Zones- also known as export processing zones, are areas, often near transport infrastructure, where goods may be landed, handled, manufactured, reconfigured, and re-exported without requirement of customs payment.
- Free Zones and Ports- designated areas where businesses are taxed very lightly or not at all for the purposes of investment and establishment, when they are located at ports, they are referred to as free ports and are often located in free zones

Further Resources

- FIAS: The Multi-Donor Investment Climate Advisory Service, Special Economic Zones: Performance, Lessons Learned, and Implications for Zone Development, World Bank, April, 2008, http://www.naftz.org/docs/news/Special%20Economic%20Zones%20report_April2008.pdf
- Wei Ge, "The Dynamics of Export Processing Zones." December, 1999, UNCTAD/OSG/DP/144
- Thomas Farole, Gokhan Akinci, "Special Economic Zones: Progress, Emerging Challenges, and Future Directions" World Bank, 2011
- Ministry of Commerce and Industry, Government of India- http://www.sezindia.nic.in/index.asp
- Philippine Economic Zone Authority- http://www.peza.gov.ph/
- Free Economic Zone Manaus, Brazil- http://www.suframa.gov.br/
- Pakistan Export Processing Zone Authority- http://www.epza.gov.pk/
- Nigeria Export Processing Zones Authority, http://www.nepza.gov.ng/index.php?option=com_content&task=view&id=18&Itemid=34
- Jebel Ali Free Zone Dubai- http://www.jafza.ae/