

# ZONE CONTRIBUTIONS TO DEVELOPMENT

## I. THE EXPORT PROCESSING ZONE CONCEPT

For countries seeking to stimulate growth of non-traditional export industries, a new type of free trade zone - the Export Processing Zone (EPZ) - offers an effective means of mobilizing new private sector resources and initiatives. Like traditional free trade zones, EPZs are areas designated by the government to provide tax and other incentives for companies engaged in international trade.

Unlike classic free zones, however, EPZs are typically engaged in the processing, manufacture, and assembly of goods destined for export markets. Thus, EPZs do not normally physically resemble warehousing/transshipment areas, but rather take the form of modern industrial estates and office parks -- usually ranging in size from 20 to 200 hectares -- catering to labor-intensive export processing operations.

Growing numbers of private developers have found EPZs to be financially rewarding projects, in cases where attractive and well-located sites are available and where host-Governments provide a competitive package of export incentives.

## II. ECONOMIC IMPACTS OF EPZs

At present, more than 40 countries have established EPZ programs. Over 140 industrial park-style EPZs are now operational, employing more than 1.2 million workers (not including the free ports of Hong Kong and Singapore, which feature EPZ-style incentives). The manufacture of textiles, garments, and electronic and electrical goods for export markets accounts for 80 percent of EPZ activity. Leather products, toys, furniture, foodstuffs, and pharmaceuticals also account for significant EPZ industrial exports.

The first modern EPZ was established in 1960 at Shannon Airport in Ireland. Within ten years, the Shannon EPZ employed 8000 workers and accounted for 20 percent of the country's manufactured exports. Taking note of Ireland's success, a number of Asian countries began in the 1960s to implement EPZ programs. Taiwan opened three such zones between 1966 and 1971, which quickly generated 70,000 jobs and over \$1.5 billion in annual exports. Following the Irish and Taiwanese experiences, Korea and Malaysia also experienced rapid success in attracting foreign investment in EPZ assembly and manufacturing sectors. In recent years, Jamaica and the Dominican Republic have pioneered a new type of EPZ -- office parks specializing in labor intensive data entry and document processing operations.

The following indicates the range of benefits that successful EPZs can achieve:

**Employment:** Industries that traditionally locate in EPZs utilize labor-intensive production processes and have made major contributions to reducing unemployment. The sixteen operational EPZs in the Dominican Republic today account for more than 105,000 jobs -- a fivefold growth in employment since 1982. In Mauritius, the EPZ regime has reduced the 23 percent unemployment rate of 1982 to less than 5 percent in 1988; labor shortages in critical sectors are now surfacing. EPZ firms now number 530 and employ over 110,000 workers in that country; in the past year alone, more than 150 new firms have established operations in Mauritius, generating over 15,000 new jobs. In both Malaysia and Taiwan, EPZs have created jobs for more than 70,000 workers. Successful zones in the Caribbean Basin, the Indian Ocean, and the Far East each typically employ between 10,000 to 20,000 workers in



the apparel and electronics assembly sectors. Although expatriates often hold the majority of managerial and technical positions in EPZ firms at early stages, nationals have taken over responsibilities as skill levels rise.

Foreign Exchange Earnings: EPZ companies are primarily engaged in export manufacturing and therefore generate foreign exchange earnings from the sale of goods and services abroad. Although EPZ firms can generally freely repatriate foreign exchange, a significant portion of their earnings is converted into local currency to pay for in-country value added, such as labor, raw materials, utilities, and transportation. The percentage of foreign exchange retained by the host country averages between 20 and 60 percent of EPZ export earnings, depending on the labor-to-output ratio and on the amount of local services and inputs used in individual manufacturing processes. During the 1970s, as Taiwan extended EPZ-style incentives to the entire country, the zones produced more than half of the country's net foreign exchange earnings. Taiwan's EPZs were emulated by Malaysia and South Korea beginning in 1971. By the 1980s, Malaysia's program was generating more than \$1.4 billion in annual foreign sales while Korea's was producing more than \$600 million. Dominican Republic free zones at present generate more than \$515 million a year in exports.

Diversified Export Sector: Many countries are highly dependent on traditional export products such as agricultural goods and raw materials which are subject to the fluctuations of world market prices. EPZs contribute to the growth of the non-traditional export sector in attracting manufacturing and light industry, thereby diversifying economic activity in the country as a whole and reducing dependence on traditional exports. In the Dominican Republic, where cuts in U.S. sugar quota have hurt the traditional economy, EPZ exports now account for more than 36 percent of total export earnings.

Backward Linkages: EPZ industries can stimulate domestic industry through the consumption of local products and services. Because foreign firms are often initially reluctant to locate in an unfamiliar environment, the presence of an EPZ allows them to establish operations with a high level of certainty that favorable conditions will be found. The proximity of zone industries to local suppliers leads to creation of business relationships that would be otherwise unlikely to form. Over time, local firms develop the skills and expertise to supply EPZ industries with higher value-added inputs. The strength of such linkages is often directly related as well to the introduction by the sponsoring government of EPZ-like incentives, including duty exemptions, for local producers in proportion to their "exports" to the EPZ firms and/or world markets. Many countries also permit indigenous firms to expand into EPZs directly, thereby further removing obstacles confronted by such firms in establishing direct trading relationships with European, North American, and Far Eastern counterparts.

Technology Transfer: In general, the technologies and skills transferred by EPZs increase as the zone matures. However, even in their earliest stages, EPZ programs contribute to the development of industrial habits, practical labor skills and business practices in the local workforce. Over time, many nationals of the host country rise to managerial, technical, and marketing positions within EPZ firms. A substantial portion of these individuals, in countries such as the Dominican Republic, El Salvador, Costa Rica, and Haiti, subsequently used the skills gained by their experience working in foreign-owned companies to form their own export-oriented enterprises, operating under production contracts to overseas clients. In addition, free zone developers have increasingly arranged links with nearby training and technical institutions, in which zone-based enterprises participate in designing, equipping, and staffing needed courses.

### III. POLICY REFORM INNOVATIONS OF EPZs

EPZs in some countries have been highly effective in introducing market-oriented economic and institutional policy reforms. Due to the limited geographic area of the zone, liberalization of economic policies often can be implemented in an EPZ without encountering widespread political opposition. Subsequently, the demonstration effects resulting from its success can strengthen the political and economic case for the designation and development of additional EPZs throughout the entire country, or in specific geographic regions. Moreover, a favorable experience with EPZs often creates pressure for economic liberalization and reform of the entire economy, thereby diffusing these policy benefits to a wide range of communities.

EPZs have historically been used by countries in their initial experimentation with market-oriented development policies. Ireland, Taiwan, Singapore, and South Korea, once all practitioners of import substitution policies, extended new export-oriented policies to their entire territory after realizing significant benefits from successful EPZ programs. Among Latin American and Caribbean nations, the Dominican Republic, Costa Rica, and Jamaica have effectively used EPZs in their efforts to reduce or remove barriers to national export production. The People's Republic of China embarked upon its industrial policy liberalization in 1978 with the designation of four "Special Economic Zones," which pioneered the freedom of employers to hire and fire workers without Community Party approval. Today, more than 140 communities in China have received similar incentives. Poland has designated four export processing zones to date as proving grounds for new economic policies, and the Soviet Union is reported to be identifying 12 sites for EPZ status.

EPZs enable countries to test out, within limited areas, "full strength" approaches to free market-oriented policy reform. Although incentives and benefits offered by EPZ program vary, they typically include:

Tariff and Tax Abatement: EPZs generally offer companies freedom from all duties, import taxes, and other levies and licenses on their imported machinery, equipment, and inputs required for the manufacturing process, as well as exemption from export fees, levies, licenses, and other charges.

Tax Relief: Corporate income tax holidays range from five years to perpetuity, with an average tax holiday of 10-15 years. Most EPZs also provide full exemptions from taxes on profits and dividends.

Liberalized Currency Controls: With few exceptions, EPZs offer zone users independent access to and autonomous control over their foreign exchange earnings, usually by permitting EPZ companies to hold their own foreign exchange accounts, or by assuring preferential access to foreign currency via a "special window" at the Central Bank. Unrestricted repatriation of capital and earnings is a standard element of EPZ incentives.

Other Regulatory Relief: EPZ regimes typically try to provide firms with significantly streamlined regulations and procedures related to the various approvals, permits, and licenses required for establishing a new export enterprise. The EPZ regulatory function is often housed in a "one-stop" institution which handles all the regulatory requirements at one location. Similarly, most EPZs have an on-site Customs presence.

In recent years, Latin American EPZs have begun to implement a further policy innovation: the demonopolization of infrastructure provision for EPZ firms. Uruguay in 1988 enacted a law explicitly allowing private sector ownership of utilities such as telecommunications, power generation, and port operations, recognizing the need of export firms for exemption from the implicit "tax" imposed by traditional public sector delivery systems. This innovation has since prompted been incorporated in free zone incentive frameworks by several African countries.

TABLE 1  
**OPERATIONAL FREE ZONES  
 IN LATIN AMERICA AND THE CARIBBEAN**

(mid 1989)

Country	# of Zones	Employment	Building Space (sq.ft)
Aruba	1	800	300,000
Bahamas	2	8,000	1,500,000
Barbados	11	20,000	2,075,000
Brazil	1	27,000	N/A
Colombia	4	6,000	N/A
Costa Rica	4	4,500	700,000
Curacao	1	3,000	800,000
Dominican Republic	16	110,000	5,250,000
El Salvador	1	3,500	550,000
Guatemala	1	400	140,000
Haiti	2	40,000	N/A
Honduras	1	3,000	300,000
Jamaica	3	10,000	890,000
Panama	1	5,000	3,233,000
St. Lucia	1	1,500	180,000
Uruguay	2	300	200,000
<b>TOTAL</b>	<b>52</b>	<b>243,000</b>	<b>16,118,000</b>

Source: The Services Group, SRI International; data for Haiti include industrial estates with EPZ-style incentives. All employment data is for direct employment only; figures for some countries are estimates.