BURUNDI: THE FREE ZONE ENABLING ENVIRONMENT

FINAL REPORT

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ACRONYMS AND ABBREVIATIONS

CBI	Caribbean Basin Initiative
CFZ	Commercial Free Zone
EC	European Economic Community
EPZ	Export Processing Zone
FBu	Franc Burundian
FTZ	Free Trade Zone
GRB	Government of the Republic of Burundi
GSP	Generalized System of Preferences
IFZ	Industrial Free Zone
LDC	Less Developed Countries
MFA	Multi Fibre Arrangement
NIC	Newly Industrialized Countries
OBU	Offshore Banking Unit
PTA	Preferential Trade Area
SFFZ	Single-Factory Free Zone
TSG	The Services Group
USAID	United States Agency for International Development

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EXECUTIVE SUMMARY

Introduction. This report presents the findings of a six-week study, undertaken for the Burundian Ministry of Commerce and Industry, to assess the Burundian enabling environment for an Industrial Free Zone (IFZ) regime. The study has been executed by The Services Group (TSG), under a contract with the U.S. Agency for International Development (USAID), and funded by USAID under the Private Enterprise Development Support Project.

Although the original contract focused exclusively on the enabling environment for IFZ development in Burundi, the TSG study team agreed, at the request of the Government of Burundi (GRB), to extend the study's scope to briefly examine the viability of commercial free zones and offshore financial services in the assessment.

Background on Free Zones. The term "free zone" is used for a wide variety of activities that are largely or completely exempt from government taxation. In general, free zone activities can be separated into three categories. The traditional free zone, known as a commercial free zone (CFZ), consists of the temporary storage and re-exportation of goods. A second, more recently developed form of free zone is the industrial free zone (IFZ) which is differentiated from CFZs in that they are host to manufacturing, processing, and assembly operations. A third type of free zone has evolved as an offshore base for financial service activities such as offshore banking, corporate registry, captive insurance, and maritime registry.

Since the first IFZ was established in 1960 in Ireland, more than 40 countries have established IFZ programs. Over 280 industrial park-style IFZs are now operational and IFZ programs now account for an estimated US$26 billion in annual exports and employ more than 3.5 million workers. IFZs have been used in a number of countries such as Taiwan and South Korea as a means to gain familiarity and experience with market-oriented development policies. Given competitive economic conditions and proper implementation, IFZs have yielded substantial economic benefits. In Mauritius, for example, IFZ companies employ approximately 90,000 workers and generate over US$500 million in exports. As a result, the unemployment rate has dropped from 23 to 2 percent in 8 years. As a result of the Mauritian success, a number of other African nations -- including Togo, Cameroon, Kenya, Madagascar, Cape Verde, and Ethiopia -- are now establishing IFZ regimes.

International Market for Free Zones. The movement of companies to IFZs has been largely the result of a wide disparity in wage rates between developing and developed countries. As a result, labor-intensive industries have increasingly shifted to offshore locations. In countries sponsoring IFZs worldwide, initial investment has historically been concentrated in the following sectors: apparel assembly and manufacturing, electronics/electrical goods assembly and manufacturing, leather/footwear production and other light manufacturing industries. However, in the past decade, the electronics sector has become more capital-intensive and thus less likely to establish offshore operations.

Within recent years there has been a growing trend of small- and medium-sized firms establishing in IFZs. These firms typically prefer IFZs near to their own country -- U.S. firms generally go to Mexico or the Caribbean Basin, Western European firms are oriented toward Eastern Europe and the Mediterranean region, and East Asian firms tend to establish operations in Southeast Asia.

Free Zone Legal, Regulatory, and Institutional Policy Environment. Although the specific incentives vary, all IFZ programs aim to provide a simplified business environment that systematically removes barriers to export sector expansion. An IFZ accomplishes this through a dual approach: first, by offering comprehensive and attractive incentives, and second, by providing a streamlined regulatory environment. A typical package of incentives includes: exemption from tariffs and duties, corporate income tax relief, and liberalized currency and ownership controls.

A wide range of institutional structures have been employed to regulate IFZs; no model has been uniformly successful or unsuccessful. The regulation of IFZs includes the following configurations: non-coordinated frameworks where investors must deal with a large number of government agencies; inter-ministerial committees comprised of all relevant ministries and institutions; single ministry frameworks such as within the Ministry of Industry; autonomous public sector bodies; or autonomous corporate models. While the trend in recent years has been to create new autonomous organizations -- as is being done in Togo and Cameroon -- this strategy is costly.

Assessment of the Burundian Environment for Free Zone Development. The GRB has introduced a number of economic reforms which have substantially improved Burundi's macroeconomic climate and prospects for exports. These include a realistic and flexible exchange rate, deregulation of import and export licenses, rationalization of import tariffs, and the elimination of export licenses and taxes. Despite these changes however, economic growth has been slow owing, in large part, to the country's heavy reliance on coffee exports and the relatively undeveloped private sector.

In terms of the cost and reliability of water, electricity, international telecommunications, and air freight, Burundi is fairly competitive with other existing and developing free zone programs. The prevailing wage rate is one of the country's strongest comparative advantages, but it remains to be seen if Burundian labor can be competitive on the basis of productivity. Burundi is severely handicapped by the unreliability and high cost of surface transportation to Mombasa and Dar-es-Salaam. Regardless of Burundi's strengths in other factors of production, the high cost of transportation effectively limits Burundi's free zone potential to the regional market and to goods with high-value to weight ratios which can utilize air freight.

A reliance on air freight would put Burundi at a significant disadvantage vis-a-vis other zone programs as air freight is much more expensive. An estimated 75 percent of free zone products are shipped by sea freight. The product most commonly shipped by air freight is electrical components, but because the movement of electronics firms offshore is slowing, it would be extremely difficult to attract electronics firms to an untested location such as Burundi. Similarly, the prospects for regional trade are not overwhelming. While the regional population is large, the buying power of these neighboring countries is limited; the average per capita GNP of Burundi's six closest countries is only US$245. The regional potential is further limited by the similarity of products manufactured in neighboring countries and by trade barriers.

Owing to these factors, expectations should be extremely modest regarding the use of regional exports as an engine for significant economic growth. There is no IFZ program operating in the world in a land-locked country, and there is only one IFZ that produces primarily for a regional market; that of Senegal, which has attracted only 6 firms after 15 years of operation.

Assessment of the Burundian Legislative, Institutional, and Regulatory Environment. As compared to other African nations, the capabilities and efficiencies of the Burundian Customs department represents a strength for export development. The same cannot be said for current administrative practices regarding investment approvals. The investment application process requires excessive documentation and is overly time consuming. Moreover, within the current institutional framework, the efficacy with which an IFZ regime could be potentially administered is unclear. There is no single agency or institution in Burundi which appears ideally suited to undertake such administrative responsibilities.

Conclusions and Plan of Action. The private entrepot regime in Burundi is very similar to the concept of a commercial free zone. Because the present entrepot system functions well, it is unnecessary for the GRB to establish an entirely separate CFZ program given the limited potential for significant CFZ activity. Modifications to the present system would allow the GRB to minimize implementation costs while expanding the present system's scope. These suggested modifications include: elimination of double key system; end use of export taxes and licenses for re-exports, lower road tariffs and eased visa requirements.

In terms of the four offshore financial services sectors, corporate registry has the most potential for short-term success in Burundi. Due to the administrative costs, difficulties, and long start-up times needed for offshore banking, maritime registry, and captive insurance, it is recommended that the GRB commence solely with a corporate registry program. This phased approach will allow the GRB to reduce administrative costs and concentrate skilled manpower within one program. The incentive package should be highly competitive and should be similar to that of the British Virgin Islands, which has experienced dramatic growth in this sector since 1985.

In terms of an IFZ, it is likely that the level of activity generated will not justify the costs of administering the program. There are several reasons for this conclusion. One, the high cost of land transport is a tremendous disadvantage. Two, levels of regional trade provide an insufficient basis from which to develop an IFZ. Three, levels of foreign investment have been negligible in recent years and Burundi's private sector capability remains limited -- at least in the short-term. Four, there are no existing institutions which appear ideally capable of promoting or regulating an IFZ program. The cost of establishing an IFZ regulatory body, as is presently being done in Togo, is approximately US$300,000 a year. Five, the substantial economic reforms adopted by the GRB have already eliminated many of the economic distortions which IFZ programs are used to counteract. These policies include reductions in import duties, reduced levels of taxation, reduction in import and export taxes, and realistic exchange rates. As such, the GRB has already created a largely hospitable economic environment.

For these reasons, it is recommended that the GRB instead concentrate its resources on improving the existing environment for exporters; it is more sensible to enhance existing mechanisms and strengthen implementing institutions than to create new ones. Many of these reforms would simply represent a modification of measures that have already been implemented. Suggested modifications to the incentive package include:

- income tax holidays on all export earnings;
- link the level of tax exoneration directly to the level of exports;
- allow exporters to automatically benefit from all tax exonerations granted under other export regimes;
- grant incentives equally to both foreign and domestic, and large and small, firms.

Among the most important reforms that the GRB should make, relate to administrative procedures. It is by no means necessary to have an IFZ program in order to implement the institutional and administrative efficiency that characterizes successful IFZ regimes. The GRB should actively consider reform of the investment approval process by simplifying documentary requirements, introducing a default mechanism, eliminating unnecessary duplication, and standardizing the incentives so that they are the same for all investors.

The recommendations outlined above for the IFZ constitute a straightforward package of measures that can directly improve the current export regime. Adoption of this approach has two advantages. First, it is the most cost-effective strategy given the limited potential of a Burundian IFZ in the near-term. Second, by utilizing existing administrative mechanisms and laws, a highly competitive program can be implemented much faster than can the establishment of an IFZ regime.

I. INTRODUCTION

1.01 The purpose of this report is to provide the Government of the Republic of Burundi (GRB) with an assessment of the Burundian enabling environment for the establishment of an Industrial Free Zone (IFZ) regime in Burundi. This study has been executed by The Services Group (TSG), under a contract with the U.S. Agency for International Development (USAID), and funded by USAID under the Private Enterprise Development Support Project.

1.02 The focus of this study is a preliminary evaluation of Burundi's potential for free zone development. The report analyzes the economic market and policy setting, and evaluates the role and relationship of free zones to the GRB's economic development goals. This report was prepared based on data gathered by a field mission in Burundi comprised of TSG staff members Karen Hendrixson and Robert Rauth from June 13-23. In addition, the team met in Brussels with Patrice de Jaegher, who authored a previous Burundian free zone study. Subsequent documentary analysis in TSG's home office in Washington, DC, was conducted under the technical guidance of TSG staff members Kishore Rao and Cecilia Sager, and with the assistance of Sylvie Morel-Seytoux.

1.03 The remainder of this report is organized according to the following framework:

- Chapter 2 consists of a discussion of the basic characteristics of three types of free zones -- commercial free zones, industrial free zones, and offshore services -- and discusses recent trends in the evolution of these zones and their contribution to economic development.

- Chapter 3 discusses the international market for free zones, including trends in international production sharing, and provides an overview of the industry sectors most commonly found in free zones.

- Chapter 4 explores the free zone policy environment. It examines the eligibility criteria for free zone firms; compares the types of free zone incentives offered by leading free zones in Africa and the world; and discusses, again on a comparative basis, the institutional frameworks and administrative procedures employed by free zones worldwide.

- In Chapter 5, the economic factors affecting the potential for free zone development in Burundi are analyzed. This includes an evaluation of the quality and quantity of Burundi's basic factors of production -- labor, land, capital, infrastructure and basic services -- on a comparative basis with other free zone countries; and an examination of current levels of manufacturing activity, trade patterns, and potential export markets.

- The current institutional and regulatory environment in Burundi is the subject of Chapter 6, which reviews export policy and incentives, Customs and other procedures affecting export-oriented businesses, and examines key Burundian institutions overseeing the export sector.

- The study's conclusions and recommendations are made in Chapter 7, where the viability of various types of free zone development for Burundi is examined, including industrial free zones, commercial free zones, and a variety of offshore services. The Chapter concludes with an action plan of proposed implementational measures.

1.04 Although the original contract focused exclusively on the enabling environment for IFZ development in Burundi, the TSG study team agreed, at the GRB's request, to extend the study's scope to include the viability of commercial free zones and offshore services in the assessment of the Burundian context. Accordingly, these types of zones are covered in the Chapter 2 discussion of the free zone concept and in the conclusions in Chapter 7. The complexity of these subjects, however, precludes their discussion in great detail; these areas are normally the subject of separate, individual studies, and for this reason they are not examined consistently throughout the text. For this same reason, the term "industrial free zone" is used uniformly throughout the report.

1.05 The study team particularly benefitted from the guidance and assistance of Donald Hart, Private Sector Officer, USAID/Burundi, and Valerie Siniremera of the Ministry of Commerce and Industry. The views expressed in this report, however, are those of the TSG project team, and do not necessarily reflect those of the Government of the Republic of Burundi or USAID.

II. BASIC CONCEPTS

A. TYPES OF FREE ZONES

2.01 The term "free zone" is used for a wide variety of activities that are largely or completely exempt from government taxation. In general, free zone activities can be separated into three categories. The traditional free zone, which has existed since biblical times, is known as a commercial free zone (CFZ). CFZ activity revolves around the temporary storage and re-exportation of goods, with the facilities serving essentially as transshipment points. CFZs are also known as free trade zones, duty-free zones, foreign trade zones, free ports, entrepots, and transit zones. A second, more recently developed form of free zone is the industrial free zone (IFZ) or export processing zone (EPZ). Industrial free zones are differentiated from commercial free zones in that they are host to manufacturing, processing, and assembly operations. A third type of free zone has evolved as an offshore base for financial service activities. These activities include offshore banking, corporate registry, insurance, and maritime registry.

B. COMMERCIAL FREE ZONES

1. Overview

2.02 A commercial free zone can be defined as a geographically secure area outside a nation's Customs jurisdiction created for the express purpose of facilitating cargo handling and transfer between major shipping routes. In general, CFZs can be differentiated from other types of free zones in that they primarily serve as transshipment and temporary storage points. Unlike IFZs, there is very little, if any, manufacturing, processing and assembly operations. Activities within the zone are concentrated on receiving, storing, re-packing, and distributing goods internationally.

2.03 It is estimated that there are some 500 CFZs in the world, and notable examples include the Colon Free Zone in Panama; the free port of Hong Kong; and the Miami Foreign Trade Zone in Miami, Florida. It has been calculated that more than five percent of total world trade passes through CFZs. Annual turnover at the Colon Free Zone averages approximately US$5 billion.

2.04 The typical CFZ incentive package includes:

- Customs tariff exemptions -- 100 percent duty-free entry and exit of all merchandise;
- tax relief -- companies located in CFZs pay nominal or no local taxes and corporate income taxes; and
- regulatory relief -- successful CFZs offer streamlined administrative procedures and straightforward regulations. Quick approval for foreign investors, simple Customs procedures, and automatic currency exchange are three critical elements for success.

2.05 CFZs are normally located directly adjacent to seaports or airports that can be utilized as transfer points for neighboring countries, or are otherwise strategically located with respect to international shipping routes. Good port and airport facilities are essential, as are efficient port workers, low port fees and an adequate supply of well-protected warehouse space. In addition, excellent banking facilities and telecommunications are necessary components.

2.06 Traditional tenants of CFZs have been multinational companies involved in international (re-export) trade, as well as trade intermediaries such as warehouse agents, freight forwarders, trading companies, and the like. In terms of the type of merchandise typically stored in CFZs, high value or luxury goods such as jewelry, electronics, appliances, watches, clothing and medical products predominate. CFZs are often used by companies as a central supply source serving multiple destinations.

2.07 The precise uses of CFZs vary greatly by the nature of the company, the location of the zone, and the final market being serviced. Among the most important benefits to firms utilizing CFZs are: accelerated landing and storing of goods, increased cash-flow as goods can be held duty-free until reaching the country of destination, cost-effective exhibition space, and reduction in insurance costs.

2. Emerging Trends

2.08 In recent years, CFZs have increasingly been linked to world trade centers and have integrated wholesale duty-free shopping, exhibition centers, and various types of tourism facilities and services. This trend has been especially evident in the Miami and Curacao free zones in the Caribbean region. Another emerging trend is the declining importance of public warehouses, as investors prefer to own their own space. To compensate for the weak demand for public warehousing, CFZs now offer management services to firms unwilling or unable to supervise their own operations within the zone. These services include packing, labeling, preparing invoices and bills of lading, Customs transactions, and any other activities required to ship the goods to their intended destination.

3. Development Benefits

2.09 CFZ host countries benefit in a number of ways from a successful CFZ program, including:

- Utilization of excess port capacity which can contribute to economies of scale through increased trade volume, reducing average cargo handling and storage costs for all traffic.

- Generation of additional shipping traffic, leading to increased competition and lower shipping costs.

- Increased demand for locally based international trade services such as Customs brokers, freight forwarders, cargo repacking, goods exposition, shipping services etc.

- Creation of employment. While CFZ operations are not labor-intensive, employment is generated for stevedores, freight forwarders, security personnel, and warehouse staff. It is estimated that the Colon Free Zone has generated over 7,000 jobs in the 1,000 companies in the zone while the Miami Free Zone has approximately 1,200 employees among its 170 tenants.

C. INDUSTRIAL FREE ZONES

1. Overview

2.10 For countries seeking to stimulate the growth of non-traditional export industries, a new type of free zone, the industrial free zone, offers an effective means of mobilizing private sector resources and initiative. Also known as Export Processing Zones, IFZs typically offer stronger incentives than similar programs such as "production sharing" (as in the maquiladoras of Mexico), and in-bond manufacturing. Like commercial free zones, IFZs are considered to be outside the national Customs territory. However, IFZs are explicitly designed to facilitate the processing, manufacture and assembly of goods and services destined (primarily) for export markets. Transactions in IFZs are not subject to import restrictions and tariffs, and therefore escape the delays and administrative costs often associated with other export promotion regimes. Typically, raw materials and intermediate goods are imported and assembled, utilizing the host country's comparative advantage of low-cost labor in the production of the final product.

2.11 The physical infrastructure of the traditional IFZ is a fenced-in industrial park ranging from 20 to 200 hectares in size. Industrial park-style IFZs offset general deficiencies in public infrastructure and services in many developing countries, and allow for the realization of economies of scale in service delivery and infrastructure provision. Internal infrastructure and services available in such IFZs range from the internal road network, electric power, gas, water, sewerage and telecommunications facilities, to canteens, banking and postal facilities, training institutions, and repair and maintenance shops, among others. Fully serviced buildings and/or improved land are rented or sold to IFZ firms.

2.12 The first IFZ was established in 1960 at Shannon Airport in Ireland. The Irish government was concerned with its stagnating industrial base and saddled with an airport made largely obsolete by long-range trans-Atlantic planes that needed no refueling stopover. As a means to reinvigorate the airport's activity, the government offered special incentives to investors willing to locate in Shannon and export from Ireland. These incentives, combined with Ireland's relatively low labor costs and proximity to the Western European market, brought about an economic resurgence in the area. Within ten years, the Shannon IFZ employed 8,000 workers and accounted for 20 percent of the country's manufactured exports.

2.13 Ireland's success was quickly emulated by a number of Asian countries, as IFZs were established in Taiwan, South Korea, and Malaysia. During this same period, IFZ-style programs were established in a number of other countries around the world, including Mauritius and the Dominican Republic.

2.14 Currently, more than 40 countries worldwide have established IFZ programs. Over 280 industrial park-style IFZs are now operational and accounting for an estimated US$26 billion in annual exports and employing more than 3.5 million workers. The manufacture of garments, textiles,and electronic and electrical goods for export markets accounts for 80 percent of global IFZ production. Of the 43 zone programs, 35 percent are located in the Asian region, 14 percent in the Caribbean, 21 percent in Central and South America, and 14 percent in the Middle East/Mediterranean region. African countries account for 16 percent of IFZ programs worldwide.

a. Single-Factory Free Zones (Enterprise Franche)

2.15 It should be emphasized that the IFZ policy regime can be applied either to a geographically defined area (usually in the form of fully serviced industrial or office parks) or to individual firms (regardless of their location) engaged in wholly export-oriented production activities. Under the framework of a single-factory free zone (SFFZ) regime, the IFZ package of incentives is provided on a case-by-case basis to individual plants producing for export SFFZs are a policy response which provides IFZ incentives to firms that, for reasons of raw material location (e.g., agricultural, mineral, seafood processing), cannot be established inside a typical IFZ area. In recent years, increasing numbers of countries are not restricting IFZs to a defined area. For example, Mauritius and Fiji have effectively expanded their IFZ programs to include the entire country.

2.16 There are a number of advantages to SFFZs as opposed to geographically delineated IFZs. SFFZs offer investors greater locational flexibility. Some firms, particularly those using local raw materials, may find it beneficial to base their operations near their source of inputs. Additionally, SFFZs allow for the dispersion of zone benefits, such as employment generation, throughout the country. As such, urban congestion and insupportable demands on infrastructure and services are more easily avoided. The establishment of SFFZs also allows firms to locate in areas that might otherwise be too small in population to support a zone with a number of firms.

2.17 Along with the potential benefits, the SFFZ approach has some negative aspects. Unlike geographically delineated zones, in which the Customs supervision and other government monitoring requirements are facilitated by the concentration of firms in a specific area, SFFZs located throughout the national territory, also require more regulatory personnel, and therefore are more expensive to administer. Many developing countries also prefer geographically delineated IFZs to SFFZs because of shortcomings in infrastructure. The establishment of a community of companies in a relatively small space enables a host government to focus its infrastructure development in one or two sites, thereby providing a cost-effective alternative to the provision of quality infrastructure throughout a country. Additionally, geographically delineated zones are often easier to promote and market to overseas investors. Because such zones are not tailored to the needs of specific industry sectors, they can be constructed in advance, enabling investors to visit the site, to ensure the adequate infrastructure is in place, and to meet other companies that have located in the zone.

2.18 It should be noted that the two approaches are not mutually exclusive. Mauritius, Tunisia, and Costa Rica allow for both industrial park-style IFZs as well as SFFZs, giving investors maximum locational flexibility.

2. Emerging Trends

2.19 Since the 1960s, IFZs have evolved in a number of ways. Many of the earliest established zones have matured, developing significant linkages to the local economy, with substantial industrial development taking place outside of the zones, or in new SFFZs. IFZs have also become increasingly sophisticated in the types of services they offer to investors and in the products manufactured. Infrastructural facilities are now often comparable to those found in developed countries, and high technology and information services industries are common in the more advanced or well-established zones.

2.20 Concurrently, the regional concentration of IFZs has changed, as the Caribbean and Central American countries have witnessed explosive IFZ development in recent years. Meanwhile, the role of the private sector in zone development and management has grown. While IFZ development was once commonly led by government ministries, agencies or parastatals, governments around the world are now allowing private investors to develop and operate zones on a profit-making basis, and to provide utilities and other services usually provided by the public sector.

3. Development Benefits

2.21 IFZs have been extremely successful as a means for governments to introduce market-oriented economic and institutional policy reforms. Due to the limited geographic area of the zone, economic policies can be liberalized in an IFZ without encountering widespread political opposition. Subsequently, the demonstration effects resulting from a zone's success can strengthen the political and economic justification for the designation and development of additional IFZs throughout the entire country, or in specific geographic regions. Moreover, a favorable experience with IFZs often creates pressure for economic liberalization and reform of the entire economy, thereby diffusing these policy benefits. In this manner, IFZs can be effectively utilized as a first step toward the integration of local producers and products into the world market.

2.22 IFZs have been used in a number of countries to gain familiarity and experience with market-oriented development policies. Taiwan, Singapore, and South Korea embarked upon zone development initiatives during the late 1960s and early 1970s, marking a departure from traditional policies of import substitution. Reduced Customs duties, simplified investment approval procedures, tax abatements, and liberalized foreign exchange controls had the effect of attracting competitive enterprises zone facilities. As these exporting firms became successful, Asian governments recognized the potential benefits to be gained by extending liberalizing reforms throughout the economy. A similar process has occurred during the past 20 years in Mauritius, where IFZ incentives were the forerunners of general tax, tariff, and regulatory policy liberalization.

2.23 If properly implemented, IFZ programs can have immediate economic benefits. These are the most readily accrued in the form of creating jobs and increasing foreign exchange earnings. Employment creation and foreign exchange earnings in several countries has been dramatic. In Mauritius, the unemployment rate has dropped from 23 to 2 percent in 8 years. The Mauritian IFZ program currently employs nearly 100,000 workers and generates US$500 million in exports. Mauritius, with a population of one million, is now the world's third largest producer of knitwear. A similar story can be recounted for the Dominican Republic, where employment in IFZs climbed from 20,000 in 1982 to 124,000 in 1989. In 1989, Dominican IFZ exports rose 37 percent to reach US$686 million.

2.24 It should be emphasized that IFZs are by no means a substitute for nationwide policy liberalization. For a country to introduce maximum economic development stimulus, the broadest possible geographic reach should be given to market-oriented policies. The formulation of backward linkages between IFZ-based firms -- which must use affordable and high quality inputs to remain competitive in the world market -- and the local business community will be impeded unless and until steps are taken to remove constraints upon suppliers in the surrounding economy. Nevertheless, IFZs can play an important role in the process of modernization, by illustrating tangible economic benefits that accrue from consistent moves in a market-oriented policy direction.

D. OFFSHORE FINANCIAL SERVICES

1. Overview

2.25 Offshore financial service activities include banking, corporate registry, insurance, and maritime registry. Many countries have tailored incentive packages to attract banks, corporations, shipping companies, and insurance companies to domicile in their country. Like IFZ activities, these offshore service companies are considered to be geographically external to the host country, and these firms are typically prohibited from conducting business within the local economy. These activities are often classified together under the umbrella term of "tax havens" and incentive packages for the each sector are often available in the same countries. While these activities can be viewed as related a country need not offer programs for all four of the offshore financial sectors to be successful.

2.26 There are a number of intrinsic conditions and infrastructure factors that play a role in the successful development of a tax haven. The basic conditions generally associated with successful offshore financial centers include the following:

- minimal differences in time zones, enabling business to be conducted during regular business hours;

- geographic proximity to wealthy nations;
- English language capability;
- overall quality of life -- often complementary with locations featuring tourism and retirement facilities;
- political stability;[1]
- British common law -- found in seven of the top ten offshore banking centers; and,
- readily convertible currency.

In addition, frequent air service links and high quality, inexpensive telecommunications are needed for successful start-up. The latter is particularly important to offshore banks and corporations as they rely to a great extent on telephones and telexes for conducting business.

a. Offshore Banking

2.27 An offshore bank, known in the banking industry as an offshore banking unit (OBU), is defined as a corporation organized and licensed under the banking laws of a sovereign jurisdiction which undertakes and facilitates international financial transactions with minimal tax, banking, and security regulations. Offshore banks conduct transactions common to all banks -- deposit-taking, lending, and fiduciary management. OBUs primarily service either Eurocurrency claims, or claims made against a bank in a different currency from that utilized in the country where the bank is located.

2.28 The majority of offshore banking transactions are undertaken by large, internationally recognized banks, and involve sums ranging from US$1 million to US$50 million. Most offshore deposits are owned by banks and are held for only a short time, as they are transferred to various branches and subsidiaries in response to interest rate changes around the world or to shelter profit from higher taxed countries. OBUs are differentiated from the bulk of the world's commercial banks in that they are operated exclusively for the purpose of conducting international transactions and are prohibited from dealing with the local economy.

2.29 Offshore banking centers offer the following incentives to banks: freedom from reserve requirements, interest rate controls, mandatory insurance participation, foreign exchange controls, and little or no taxation. Strong secrecy clauses and freedom to hire expatriates are also essential. The absence of even one of these incentives can cripple a fledgling OBU program. This is because OBUs operate on such small margins -- typically under one percent.

2.30 Offshore banking has diffused to many locations outside Europe such as Hong Kong, Singapore, the Bahamas, Bahrain, Panama, and the Cayman Islands. The offshore banking has approximately US$1 trillion in assets -- a 78 percent increase since 1982 -- with average annual growth of US$148 billion. At present, the largest offshore banking center is the Cayman Islands (with 506 banks) followed by the Bahamas (260 banks), Panama (110 banks), and Luxembourg (100 banks).

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[1] In Panama, offshore banking assets dropped from US$40 billion to US$10 billion in the last few years due to political tensions.

b. Corporate Registry

2.31 The establishment of "trust companies," "holding corporations," "shell companies," or "dummy corporations" -- the various labels ascribed to corporations registered offshore -- has been a growing trend in recent years. Companies are registered offshore in countries that have minimal or no tax on income that is earned in other countries, no tax on transactions, and complete freedom from currency controls. Subsidiaries can typically be established in one day, and although they may conduct only minimal operations themselves in the host country, they can serve as the parent company's profit center. The practice of transfer pricing -- by which products and services are sold at a modest price to a low tax center and then invoiced on to the ultimate market at a higher price -- enables the holding company to escape higher income taxes in countries such as the United States. Similarly, trust funds can be managed in tax havens for designated beneficiaries with the wealth accumulating free of tax or subject to a very low tax.

2.32 The largest number of offshore corporations can be found in the Caribbean Basin. Panama is reportedly the largest center for corporate registry with 35,000 companies, with the Bahamas, Netherlands Antilles, Cayman Islands, and Channel Islands having between 18,000 and 30,000 companies each. The fastest growing tax haven might well be the British Virgin Islands which has benefitted tremendously from the political instability in Panama. This program, started in 1985, now has 22,000 companies.

c. Captive Insurance

2.33 Subsidiary companies wholly owned by a non-insurance company are often established to underwrite the insurable risks of the parent company or its related companies. Captive insurance centers, like corporate registration centers, have little or no taxation on the accumulation of funds and allow for complete freedom from currency controls. In addition, the regulatory procedures are generally less stringent than those in other locations. The establishment of captive insurance companies is attractive to parent companies for a number of reasons: (1) the cost of self-insurance is often less than rates offered from commercial insurance companies; (2) it may be impossible to obtain coverage for some high-risk activities; (3) the reserves, because they are located in a tax haven, can accumulate without being subject to any substantial tax; and (4) tax havens present few regulatory responsibilities and reporting requirements.

2.34 Bermuda is by far the most important captive insurance center with over 1,100 offshore insurance companies. Cayman Islands, Guernsey, and Barbados are next in importance with between 140 to 370 companies each. As a result of troubles unique to the U.S. insurance industry, the captive insurance market has been dominated by U.S. investors. The rapidly escalating cost of insurance in the United States has boosted captive insurance tremendously and it is now estimated that offshore insurance companies comprise 35 percent of the U.S. market, depriving commercial insurers of US$50 billion in annual premiums.

d. Maritime Registry

2.35 Maritime registry, also known as flags of convenience, has been proliferating since World War II. Flags of convenience provide a haven for ship owners who wish to cut labor costs, escape corporate income tax, and avoid rigorous maritime regulations. Approximately 30 percent of total world ship tonnage is registered in four maritime registry centers. These four are Liberia (13 percent of world tonnage), Panama (11 percent), Cyprus (4 percent), and the Bahamas (2 percent).

2.36 Aside from carrying a foreign flag and reducing costs, however, offshore shipping registry imposes very few changes on shipping fleets. Neither the ship owners nor the shipping company are required to establish a resident office in the place of registry; the ships, in fact, never even have to visit the country in which they are registered. Likewise, it is not even necessary for a country to have a maritime fleet of its own in order to offer offshore shipping registry. None of the four leading registry programs listed above have significant home fleets of their own.

2.37 Following the examples of the four main flags of convenience, a number of other developing countries have also begun offshore registries. New developing country entrants include Singapore, Hong Kong, Kiribati, Honduras, and Vanuatu, among others, but a number of developed countries have also begun such programs in recent years. The development these new offshore registries has sharply heightened competition in the industry. Combined with the high cost of transferring ship registration from one country to another, it has become increasingly difficult for new countries establishing registries to attract ships.

2. Development Benefits

2.38 Tax havens have created substantial benefits for their host governments. Although governments generally levy few or no taxes on these institutions, public revenues through registration and annual fees can be substantial. The financial services sector in the Cayman Islands accounts for 40 percent of government revenue, while in the British Virgin Islands, 25 percent of the annual US$32 million budget is earned from this sector. The importance of the sector is even more important in the Netherlands Antilles, where tax haven revenues comprise US$200 million of the US$350 million annual budget.

2.39 Offshore financial services can also be a source of local employment. It should be emphasized, however, that the generation of a significant level of employment is a long-term prospect, given the highly sophisticated and specialized nature of these industries. While 3,300 jobs in the financial services sector have been created in the Bahamas, of which 90 percent are filled by Bahamians, the Bahamas began its program in the late 1950s. This is not a very impressive level of job creation over a 30-year period. Additionally, tax havens have stimulated considerable indirect economic activity and employment through local expenditures and related activities, for example in tourism and construction.

2.40 Concurrent with the benefits, however, offshore financial services can present potential problems for the host country. The reputations of governments, such as Panama, have been discredited by the discovery of caches of money deposited by drug dealers and arms smugglers. The large sums of money that are attracted to tax havens can also encourage corruption among both private citizens and public officials. Moreover, political and diplomatic sensitivities can be offended by some offshore transactions, particularly when the money deposited is the result of ill-gotten gains from corruption or from trade in drugs or arms. Finally, because the preservation of privacy and confidentiality is fundamental to the successful establishment of an offshore banking program, it is extremely difficult for governments to closely monitor transactions from a regulatory standpoint, thereby making it difficult to control the entry of such illegal funds.

III. THE INTERNATIONAL MARKET FOR FREE ZONES

3.01 As the price of labor has increased dramatically throughout the developed world, and the competition for international markets has grown, manufacturers have been forced to consider alternative strategies to offset increased production costs. For many industries in the United States, Asia, and Europe, the solution has been to move certain segments of manufacturing activity offshore to locations which provide an abundance of low cost labor.

3.02 This trend has been facilitated by the creation of IFZs in many developing countries. IFZs -- offering high quality facilities, tax advantages, and an abundance of low cost labor -- have been increasingly able to attract developed country companies whose manufacturing activities are relatively labor intensive. The search for lower labor costs, combined with the establishment of IFZ sites, has given developing countries a strong mechanism by which to attract foreign investment and promote their economic development.

3.03 Historically, the apparel and textile industries have been the key users of IFZs in the developing world. However, other manufacturing activities such as electronics, light manufacturing, and -- to a limited extent -- agro-processing, have also benefitted from locating within IFZs. As such, this chapter will provide a brief overview of trends in offshore investment, followed by an examination of manufacturing sectors which have been the key users of IFZs throughout the developing world.

A. TRENDS IN INTERNATIONAL PRODUCTION SHARING

3.04 The past four decades have witnessed the fundamental restructuring of the organization and distribution of manufacturing operations. As the comparative economic advantages of the older, industrialized countries have shifted, an internationalization of production processes has taken place. This encompasses a global redistribution of industry based on the complementarities between factors of production in developed and developing countries. Low-skilled assembly work is increasingly being performed in low-wage areas that have an abundance of untrained labor, while more highly skilled operations are being conducted in developed countries where skilled labor and technological and scientific resources are plentiful. IFZs have been the selected site by many companies as the most appropriate place to perform the low-skilled portions of their assembly operations.

3.05 This phenomenon of "production sharing" is a relatively recent development. Although locating production operations overseas to serve new markets has long been an investment strategy employed by U.S. manufacturers, volume offshore manufacturing for re-export to the home market or other markets is a qualitatively new dimension of foreign manufacturing operations that emerged in the 1960s.

3.06 Production sharing is essentially a reactive strategy of firms based in industrial countries that face competition from low-cost imports. In an attempt to defend domestic markets against international competition (as opposed to an aggressive move against domestic competitors) producers have transferred abroad those production processes in which they have lost their international competitive advantage. Several factors contribute to this phenomenon:

- Labor costs in developed countries have risen dramatically, rendering most labor-intensive processes uneconomical.
- Advances in technology have drastically reduced international communications and transport costs.
- Recently enacted tax laws and trade programs of industrialized countries encourage the offshore assembly of locally made components.
- Firms based in industrialized countries are facing increased competition from Far Eastern imports.
- Rental, purchase, and construction costs for offshore plants are typically lower than those for equivalent facilities in traditional locations.

3.07 A number of developing country locations have increasingly benefitted from these trends and are beginning to orient their own economic development strategies to take advantage of them.

B. GEOGRAPHICAL COMPOSITION OF FREE ZONE FIRMS

3.08 Confronted with similar competitive pressures, the reactions of U.S., Japanese, and European firms have been markedly different. As domestic labor-intensive production became less economical, U.S. firms began to shift production offshore for later re-importation to the domestic market, often locating in IFZs throughout the developing world. Assembly abroad is an important feature of the U.S. economy, accounting for 15 percent of the total manufactured imports. Over one-fifth of these goods come from developing countries. For certain industrial sectors, such as apparel and electronics products, a much higher percentage of products are assembled abroad.

3.10 Conversely, the industrially advanced countries of Europe have responded to worldwide competition by importing low-cost labor; a move necessitated in part by EC restrictions regarding re-importation of goods produced offshore. The amount of re-imported assembled goods entering Europe, however, is still significant. In 1987, for example, European re-imported products assembled offshore reached US$4.2 billion, mainly in apparel. Most garments re-imported in the EC are assembled in Eastern Europe. France and Germany account for almost 80 percent of the EC market for such imports from developing countries. Germany's imports are primarily from Southeast Asia, while France receives 75 percent of its re-imports from its former colonies in North Africa.

3.11 Japanese firms, faced with their own rising production costs, initially pursued a third strategy by investing in automation. This high-tech approach has worked well in some sectors; however, a large number of firms endeavored to transfer their production to lower cost locations such as Singapore, South Korea, Malaysia, and Hong Kong. In contrast to their U.S. or Western European counterparts, Japanese manufacturing firms are generally more inclined to use their foreign affiliates as low-cost platforms for exports into third-country markets. At present, more than 70 percent of the output of Japanese offshore plants in Asian locations goes to local or third-country export markets, especially to the United States.

3.12 In addition to large multinationals, increasing numbers of smaller firms, most notably Japanese firms, have moved offshore. Small firms generally tend to stay closer to home -- U.S. firms often move to IFZs in Mexico and the Caribbean Basin, Japanese firms to Taiwan and South Korea, and Western European firms to Eastern Europe and the Mediterranean. These firms favor offshore sites near their Asian home office because it can reduce overhead investment costs, make it easier to maintain close control over foreign operations, and facilitate communication.

3.13 The cost competitiveness of the Far Eastern NICs -- South Korea, Hong Kong, Singapore, and Taiwan -- which originally received the bulk of offshore investment, has eroded as their domestic wage levels have risen. U.S. manufacturers have increasingly invested in IFZs in Mexico and the countries of the Caribbean Basin to remain competitive in the face of rising sophistication of Asian imports and increasing domestic costs of production. This trend has been accentuated through the passage of the U.S. Caribbean Basin Initiative (CBI) legislation which has given regional producers a strong comparative advantage for the preferential entry of some products into the United States.

3.14 Ironically, the economic successes of the NICs, and accompanying increases in their domestic operating costs, have encouraged these emerging industrial powers to seek less expensive production sources in Asia, particularly Sri Lanka, Bangladesh, and Indonesia. For Hong Kong investors, China has also proven to be an accessible and inexpensive production site (although investment may be slowing in recent years due to the political climate).

C. SECTORAL COMPOSITION OF FREE ZONE FIRMS

3.15 Over the past decade, IFZ activity in developing countries has oriented toward three major sectors: apparel, electronics and electrical products, and other light manufacturing (such as sporting goods, footwear, jewelry, etc.). In addition, agro-processing industries hold considerable potential in countries where agricultural production is already an important part of the economy. IFZs in the more advanced developing countries and in NICs have also successfully attracted investment in scientific and other precision instruments, pharmaceutical, and information processing, but these sectors have characteristically been developed after zones have gained experience in more traditional IFZ activities. This section, accordingly, examines market activity and trade patterns in sectors of greatest near-term potential for low and middle-income developing countries embarking upon IFZ development.

1. Apparel Sector

3.16 Apparel/textile manufacturing firms are among the leading users of IFZs in LDCs. The sheer size of the apparel and textile markets (total worldwide imports exceeded US$128 billion in 1986), coupled with the moderate-to-high rates of growth in LDC export market share worldwide (especially in North America and Western Europe), have made them a foundation of LDC industrial development.

3.17 The principal markets for apparel exports from LDCs are North America and Western Europe, with over 75 percent of LDC production destined for these two markets. Only 10 percent of production in developing countries is traded intra-regionally.

3.18 In examining the growing role of the developing world in international apparel production, an understanding of the Multi-Fibre Arrangement (MFA) is essential. This agreement provides an international framework that regulates the textile and apparel industry through the establishment of quotas and export growth limitations to facilitate the liberalization and expansion of global textile trade, while avoiding major disruptions in individual markets. The most recent MFA agreement severely restricts exports to industrialized countries, especially for goods originating in Asia (primarily the NICs). As a result, Asian manufactures have begun to move to offshore locations not subject to MFA restrictions in an effort to re-establish market access and maintain market share. In addition, industrialized country producers in the U.S. and Europe have also moved offshore in response to competitive pressures from Asian producers.

3.19 Although current production trends in the apparel industry are toward higher-value products that are more fashion-sensitive and use higher quality fabric, growth is still evident in the low-value product lines. As such, low-cost producers have the opportunity to capture market share in the low-value product categories over the medium-term. Furthermore, apparel products (and textile goods to a lesser extent) are highly labor-intensive, with labor content in value-added reaching 80 percent in the United States.

3.20 Production technology is straightforward and simple for traditional low-value apparel products and textile materials, and labor skill requirements are basic. As a result, these operations are easily transferred to developing countries. Basic apparel and textile products also have a relatively low value-to-weight ratio, and because they are not time-sensitive they can be transported by ocean freight. In most cases, labor savings achieved as a result of using low-cost labor more than offset transportation costs.

2. Electronics Sector

3.21 Electronics manufacturing and assembly firms have historically played a major role in the evolution and diversification of industrial activity in free zones worldwide. Asian free zones have been particularly successful in attracting electronics manufacturers after having successfully established export operations in other light industries (e.g., apparel/textiles, toys, footwear, jewelry). It is important to note, however, that unlike the apparel/textile industries, wage costs for electronics firms are becoming less important relative to quality considerations, and growth in offshore investment by such firms in new, lower-cost countries is slowing.

3.22 The electronics industry is comprised of five basic sub-sectors: automatic data processing machines; telecommunications equipment; consumer electronics; electronic components; and business electronics. Experience indicates that the electronic components sub-sector of the industry is most suited for offshore production. Electronic components are the building block for all electronics products, ranging from radios and televisions, to telecommunications equipment and business computers. More specifically, the electronic components most suitable for offshore production are those with the following characteristics: a high labor content; straight-forward production processes; high value-to-weight and price-to-volume ratios; and constant design technology in the short-term.

3.23 While the role of LDCs in the global production of electronics has been substantial, most offshore electronics assembly operations have been concentrated in the Asian NICs, and recently in Thailand and Malaysia. As improving economies in the traditional producers of East Asia have led to a rise in the wages and standard of living, labor costs have risen to uncompetitive levels for many assembly operations, and as a result, highly cost-sensitive assembly operations have begun to move out of East Asia. While this trend will probably continue, there is also a growing emphasis on quality control and the importance of this factor is beginning to outweigh marginal differences in labor costs. Moreover, the competitiveness of the industry, as well as the industry's sensitivity to cost and quality, is leading to the increased use of automation.

3.24 There are a number of forces which are presently driving electronic component manufacturing and assembly operations to LDC countries. As mentioned, the opportunity to reduce labor costs in the production of low-end products, such as passive components, is becoming increasingly important as the electronics industry becomes more cost competitive. Second, market access and proximity to end-markets is becoming crucial as a motivation to move offshore, primarily to avoid trade barriers erected against many Far Eastern producers. For instance, Mexico has become a substantial supplier of a number of types of components due to preferential tariff treatment under the U.S. tariff programs. Finally, the industry is under pressure to diversify production bases as a means of hedging against the economic and political risk inherent in using a single production facility.

3.25 Experience indicates, however, that even in a highly successful IFZ regime, electronics production may be difficult to attract and sustain. In Mauritius, which is home to the most successful IFZ regime in Africa, there were six IFZ electronics firms operating between 1976-77, and electronics accounted for 20 percent by value of all industrial exports. By 1987, however, there were no electronics firms operating in Mauritius. The demise of the industry has been attributed to the problems of factories easily becoming obsolescent in a sector where technology and markets change rapidly and where large investments are required.

3. Light Manufacturing Sector

3.26 Other light manufacturing industries include a wide range of products and processes, such as the production of jewelry, toys, footwear, leather products, and sporting goods. Historically, light manufacturing has been a significant contributor to free zone industrial activity. As in other industries, light manufacturing firms have been drawn offshore by the attraction of low-cost labor. Products utilizing abundant local craftsmanship and simple production processes, such as simple sporting goods, toys, costume jewelry and leather goods can capitalize on both the existing skills in the labor force and the availability of locally produced raw materials.

3.27 Traditional light manufacturing generally requires only simple industrial facilities, and production is easily segmented, with most processes being highly labor-intensive. As non-perishable items, transportation costs can be kept to a minimum by utilizing ocean transport. Some products, such as costume jewelry, have a high value-to-weight ratio, and thus have lower transportation costs. As a result, products such as these can utilize both air and ocean transport.

4. Agricultural Produce and Products Sector

3.28 The spectrum of activities encompassed by agro-industry is extremely broad, ranging from the simple packaging and sale of food or food products for local cash markets, to the large-scale, complex processing and international trade of high value-added products. The industry holds considerable promise for successful development in economies which have a substantial agricultural base.

3.29 The European Community is the world's largest market for processed fruit and vegetable products, consuming approximately US$ 13 billion in 1988. It should also be noted that despite its relatively small population, the Middle East imports large quantities of agro-processed goods.

3.30 Typically, agro-processing industries prefer to locate in areas close to needed raw materials. They generally consume large quantities of water and generate significant amounts of organic (non-toxic) wastes. While the facilities and service requirements for the industry vary depending on the production processes employed and products produced, for a technology-scarce location without prior experience in the industry, capital investment requirements may be significant. Further, reliable inland transportation is crucial for the transport of perishable primary goods. Both the export of primary agricultural produce as well as agro-processing activities typically require refrigerated storage and utilize unskilled labor.

3.31 The Costa Rican export contract regime has been highly successful in encouraging agro-industrial exports. The export contract regime (or partial export regime) offers many, but not all of the same benefits and incentives as does a typical IFZ; additionally, some benefits -- such as the percentage of tax relief offered -- are linked to the percentage of output exported. In 1987, of the 380 firms operating under the export contract regime, 53 were agro-industrial in nature, with over 6,000 employees (primarily in cut flowers). Total agro-industrial exports in that year reached US$259,000. Additionally, the firms in the Costa Rican regime are predominately of local origin. The Mexican "maquila" industry has also successfully developed its agro-industrial base. In 1986, there were 14 food packing and canning companies, with a total of 2,185 employees. The total value-added from this sector reached US$11 million in 1986.

3.32 Agriculture-related activities in IFZs have typically been limited to agro-processing industries. However, some countries, such as Sri Lanka, have successfully extended the free zone benefits to include the production of agricultural primary products for the export market. These activities include the export of foliage plants, cashew kernels, and other agricultural produce. The Sri Lankan free zone program has also been active in the development of its food and agro-processing industry, mainly in the areas of cashew and tobacco processing.

3.33 Overall, however, free zone regimes have been largely unsuccessful in promoting the development of agro-industry in LDCs. In 1988, for instance, less than 2 percent of exports from the Dominican Republic free zone regime were agro-industrial in nature. This low level of agricultural activity is common to most IFZs throughout the developing world.

5. Summary

3.34 As discussed, a broad spectrum of industrial and service activities have been productively undertaken in developing country locations worldwide. The most crucial step in the development of a successful free zone program is to accurately identify those industries best suited to the advantages inherent in the location.

IV. FREE ZONE LEGAL, REGULATORY, AND INSTITUTIONAL POLICY ENVIRONMENT

4.01 Successful IFZ development is a globally competitive business. Prospective foreign investors compare alternative zone programs and incentive packages as a key element of site selection. Local investors perform a similar type of analysis, comparing IFZ investments to alternative investment opportunities either locally or abroad. While other factors are also critical to the investment decision process -- basic cost considerations and other factors of production -- the legislative and regulatory framework is a key means by which governments can distinguish their programs from competing IFZs. Equally important, the design and ultimate shape of the regulatory framework can be used to offset or compensate for inherent weaknesses. In the final analysis, the content of legal and regulatory framework and the efficiency with which it is implemented and administered, are the two most important factors in the success or failure of a free zone regime.

4.02 The careful formulation of the regulatory framework which governs and facilitates IFZ development is the foundation of any successful IFZ program. The legal framework may comprise a single law, accompanied by implementing regulations -- such as in Uruguay -- or may involve tens of laws and implementing regulations -- as in Taiwan and Hong Kong. In all cases, well-drafted legislation should encompass not only the incentives and other benefits offered to IFZ users, but should also contain explicit provisions to ensure that they are effectively implemented. It should reflect a thorough knowledge of the legal configuration and content of competing IFZ regimes, as well as a realistic understanding of what is desirable and feasible within the existing economic and institutional environment in each individual country.

A. ACCESS TO ZONE BENEFITS/ELIGIBILITY

1. Eligibility Criteria

4.03 The determination of who is eligible to participate in an IFZ program is a central concept in defining an IFZ regime. IFZ legislation must establish what types of firms and operators have access to IFZ incentives, to what degree they may avail themselves of those incentives, and where they may locate their industries. Thus, the legislation must delineate the breadth of the program -- whether individual factories may qualify as specialized IFZs; whether foreigners and local businesses have equal access to IFZ incentives; if incentives are available to partial exporters, service providers, and zone developers; and whether private IFZs will be allowed. Similarly, the scope of activities allowable under the IFZ regime must also be defined -- are certain types of activities prohibited or especially encouraged, are certain industries reserved for the state, or is the IFZ program structured to foster the development of specific types of production such as high-technology industries? These areas will be explored below.

a. Breadth of Eligibility

4.04 The determination of the entities that are eligible for IFZ status defines the scope of any IFZ program. Traditionally, beginning with the first free zone programs established in Asia, businesses receiving for IFZ status were narrowly defined to include only companies operating within an industrial park type of IFZ, as in South Korea and Taiwan. More recently in other countries, however, free zone status is granted on a much broader basis. For example, in the Dominican Republic, free zone incentives are granted to free zone operators, free zone businesses, and free zone investors who finance IFZ development. Moreover, under Dominican law, individual factories can be designated free zone firms. Similarly, eligibility for partial free zone benefits has also been included in a number of IFZ programs. In Costa Rica, local companies supplying goods totally or partially made in the country to IFZ firms benefit from tax and excise relief.

b. What Types of Activities Qualify

4.05 IFZ laws worldwide vary greatly in the specificity and of the types of permissible activities. As typified by Costa Rica's IFZ law, however, the standard definition of the types of activities allowed in IFZs encompasses the "manipulation, processing, manufacture and production of articles destined for export or re-export to third countries." Dominican law expresses the same general intent, but in a more expansive form; under the law, businesses operating in free zones can:

> Introduce, store, package, recycle, exhibit, unpack, manufacture, set up, assemble, refine, process, operate and handle all types of products, merchandise, and equipment.

4.06 Other laws go further, however, sanctioning a much wider range of activities than those indicated in this general definition. Under Costa Rican and Uruguayan law, for example, export-oriented warehousing and basic transshipment operations also qualify for IFZ firms. The Dominican law likewise provides for a wide range of IFZ services including telecommunications, technical drawing, translation, printing, and computation.

4.07 The objective of such wide-ranging laws has been to broaden their coverage to include virtually every legitimate business activity that contributes to export development. By contrast, while these countries have increasingly expanded the realm of activities eligible for IFZ status, countries such as Hong Kong and Taiwan have in some cases deliberately narrowed the scope of permissible operations. Hong Kong has restricted participation in its industrial estates program to high-technology, high value-added operations, while Taiwan has created a separate IFZ incentives regime and an industrial park specifically built for scientific and technologically complex firms. This has been done to foster the development of more sophisticated, high technology industries within the IFZs and to broaden their industrial base.

c. Where Zones Can Be Established

4.08 IFZ programs differ widely in the geographical and physical locations where IFZs can be established. In many countries, IFZ sites consist solely of industrial parks established at locations selected by the government, as in South Korea. At the opposite extreme lies the IFZ program of Mauritius, under which the entire country has been extended IFZ benefits and individual factories located anywhere on the island can qualify for IFZ incentives. Uruguay and Costa Rica fall between the two extremes. In both countries, a number of government-owned IFZs have been established, but companies or private IFZ operators also have the option of locating anywhere within the country, subject to government approval.

*The site selected for IFZ development and the restrictions placed on IFZ location can have a substantial impact on the success of an IFZ program. Under Costa Rica's 1981 law, two government-operated free zones were established as sites for companies seeking IFZ incentives. IFZs were designated in these two locations as part of a national policy to direct investment into underpopulated, economically depressed areas. Under this law, no new IFZs were to be authorized until these IFZs were fully occupied, except for certain operations that were technically impossible in those two locations. Moreover, eligibility for incentives was automatic for companies establishing in the government-operated zones, while firms wishing to locate outside their boundaries were subject to lengthy admission procedures. Such restrictions on IFZ location substantially hindered IFZ growth in Costa Rica, and it was not until 1984, when the law was amended to permit IFZs to be established outside of these regions, that Costa Rica's IFZ program began to experience substantial growth.

4.09 There are advantages and disadvantages to allowing IFZ development to occur anywhere in the country, as opposed to designating specified sites. The chief advantage to permitting country-wide IFZ development is its attractiveness to potential investors who are thus able to select the optimal site for their business. The primary disadvantage of decentralized, country-wide IFZ activity is that it places a greater strain on the national economic infrastructure and the government's abilities to administer the regime. For countries in the initial stages of IFZ development, it is usually preferable to focus upon industrial-park style IFZs, where the quality and reliability of infrastructure and services can be ensured. This does not mean, however, that IFZ legislation prohibit firms from locating outside geographical enclave-style IFZs. Instead, such designations should be made only on a case-by-case basis, based upon a careful consideration of the firm's locational requirements, such as proximity to raw materials, environmental impact, and other factors.

B. TYPES OF INCENTIVES OFFERED

4.10 Hundreds of IFZs have been established around the world today. Although they vary in size, design and market orientation, they share an essential characteristic. All IFZs provide a simplified business environment -- including tax, tariff and/or regulatory incentives -- to encourage investment in a specified area. The incentives offered differ depending on the host country, the structure of the zone itself, and in some cases, the nature of the industry, or industries, involved. The incentives and regulatory environment found in free zones have evolved significantly over the years from the simple duty relief commonly associated with commercial free zones. With the development of IFZs, a comprehensive package of duty, tax, and regulatory incentives became available to export manufacturers.

4.11 Notwithstanding variations in the types of IFZ incentives provided by host countries, the key characteristic of the IFZ approach is to systematically remove barriers to export sector expansion. Unlike other regimes offering partial incentives for export manufacturing which are discretionary and difficult to administer, IFZ incentives are generally conferred on a blanket basis to qualifying firms without the need for elaborate criteria. IFZ programs excel in the two critical elements determining the success of export regimes: the comprehensive nature of the incentives, and the streamlined procedures for granting access to them.

4.12 The comprehensive nature of the incentives package of the IFZ counter-balances the distortions experienced by manufacturers operating in typical developing country environments that may impede their ability to compete in international markets.[1] By comprehensively offsetting the deterrents to export production, IFZs place developing country manufacturers on an equal footing with their competitors operating in market-oriented economies with relatively free-trade status.

4.13 A typical package of IFZ incentives would include the following incentives.

- **Tariff and trade taxes and duties exemptions**. IFZs offer full exemption from all direct and indirect duties, taxes and other levies and licenses on imports of capital equipment, spare parts, raw materials and intermediate goods to be utilized in the export manufacturing process, as well as full exemption from all export licenses, fees, taxes, and other charges.

- **Tax relief**. Zones offer corporate income tax relief in the form of tax holidays ranging from five years to perpetuity, or a low flat tax rate. Most zones also provide full tax exemptions on profits and dividends, and allow for the unrestricted repatriation of invested capital and earnings.

- **Liberalized currency and ownership controls**. With few exceptions, most IFZs offer zone companies independent access to and autonomous control over foreign exchange earnings. Most often, zone firms are allowed to independently maintain bank accounts denominated in a hard currency. In some

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[1] Typical market distortions include such variables as overvalued exchange rates, high duties on direct and indirect imports, limited market size, poor infrastructure, high rates of taxation, controlled access to foreign exchange, shallow credit and capital markets, and restrictive labor codes that limit the employer's ability to hire, fire, and compensate workers in accordance with market pressures.

countries with controlled (and overvalued) exchange rates, a two-tiered exchange rate system has been utilized which allows zone firms to have access to foreign exchange at a "free market" rate. IFZs also generally do not discriminate between local and foreign capital; one of the strongest incentives is 100-percent foreign ownership of IFZ enterprises.

- **Regulatory relief.** Among the most important incentives of IFZ regimes is the reduction in normal government regulations and procedures that is provided to investors. Typically, IFZs streamline the various approvals, permits and licenses that are required for establishing a new business. The IFZ regulatory function is usually housed within an independent "one-stop-shop" or "guichet unique" institution which fulfills all requisite regulatory requirements at a single location.

Table 4-1 compares the incentives packages of leading free zones worldwide.

4.14 In addition to these basic incentives, many countries offer additional benefits to IFZ firms. The most common of these include:

- sales of a percentage of goods produced to the local market upon payment of relevant import duties;
- differential incentives for locating in sites distant from urban centers;
- subsidized factory and office space rental and/or utility rates;
- subsidized employee training programs; and
- changes in labor codes.

4.15 Other than local market access, such secondary incentives are generally peripheral to the operating concerns of export industries, and it is doubtful that they play an important role in attracting IFZ firms. Moreover, some of these practices may be detrimental to the overall competitiveness and profitability of an IFZ program. Subsidized factory rates, for example, compromise the financial integrity of the zone, thereby draining it of the necessary resources for maintenance and upkeep. Subsidized rates also attract "low-end" producers who are highly sensitive to rental increases and tend not to be stable, long-term tenants. Likewise, incentives designed to encourage firms to locate away from urban centers are in many cases insufficient to overcome the added burden of inadequate infrastructure and the lack of access to a large, trainable work force. Finally, labor code modifications, such as easing minimum wage requirements, have generated worker unrest and resentment in some IFZs and have thus actually inhibited zone performance.

C. ADMINISTRATION AND IMPLEMENTATION

1. Institutional Framework

a. Types of Frameworks

4.16 A wide range of alternative institutional structures have been employed to regulate IFZs; no model has been uniformly successful (or

TABLE 4-1
COMPARISON OF EXPORT INCENTIVES
IN SELECTED COUNTRIES

	Cameroon (IFZ)	Dominican Republic (IFZ)	Mauritius (IFZ)	Senegal (IFZ)	Togo (IFZ)
Corporate Income Tax Abatement	100% exemption for the first 10 years; 15% tax thereafter	100% exemption for 15-20 years depending on location	15% tax rate	100% exemption until year 1999	100% exemption for the first 10 years; 15% tax thereafter
Capital/Profits Repatriation	Unrestricted	80-100% exempt depending on location	Unrestricted	Unrestricted	Unrestricted
Duty Treatment for All Imports and Exports	100% exemption	100% exemption	100% exemption	100% exemption	100% exemption
No. of Days To Receive Approval	30	30	20-40	Not available	30
Tax on Dividends	100% exemption in perpetuity	80-100% exemption depending on EPZ location	100% exemption for 10 years	100% exemption	100% exemption in perpetuity
Restrictions on Foreign or Local Ownership	None	None	None	None	None
Sales To Local Market	Variable; decided on a case-by-case basis	20% of total output	10% of total output	20-25% of total output unless disruptive to local industry	20% of total output
Management of Foreign Currency	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted

Source: Compiled by TSG.

unsuccessful). The effectiveness of the various models depends to a large degree on the local political and economic environment; regulatory bodies with structural weaknesses, for example, have sometimes overcome these flaws through autonomy and strong leadership. The effectiveness of a regulatory agency thus typically has as much to do with its implementation as with its structure.

4.17 With this caveat, it is possible to examine the different regulatory configurations used in IFZ programs around the world. IFZ regulatory systems can have various forms. These include:

- Non-coordinated frameworks
- Inter-ministerial frameworks
- Single ministry frameworks
- Autonomous public sector models
- Corporate models

4.18 **Non-coordinated frameworks**. The most common regulatory environment found in IFZ countries is the uncoordinated regulatory structure. This is the complete opposite of the one-stop-shop. This structure represents the greatest difficulty for investors (particularly foreign investors who are unfamiliar with the workings of the local bureaucracy) who must go to a number of ministries and agencies to collect needed forms, signatures, and approvals. In addition to the large amount of time needed, this process increases the opportunities for corruption. Similarly, investors working under this arrangement typically have to hire lawyers, consultants, or other professional assistance to fill out application forms and to ensure that the approval process does not become mired in bureaucratic requirements.

4.19 While this type of framework is still being utilized in Mauritius and El Salvador, the success of the first two programs should not be construed as an endorsement of its effectiveness. In both cases, it took more than a decade for IFZ programs to establish reputations for predictable and virtually automatic approvals of IFZ applications. The IFZ program in Mauritius has succeeded despite the regulatory environment, not because of it. The investment process in Mauritius consists of 25 steps after an investor has received the IFZ certificate. As a result, it typically takes an enterprise three to six months to become operational after approval is granted. If not for the confidence in the favorable outcome of the approval process, and the low-cost factors of production, few foreign investors would tolerate such delays.

4.20 **Inter-ministerial committee frameworks.** A second option is to create an inter-ministerial committee for the regulation of IFZs. These committees are usually comprised of all relevant ministries such as Industry, Foreign Trade, Economics, Finance, and other agencies such as the Central Bank, Customs, and the President's or Prime Minister's office. This method is utilized in both Malaysia (for investments over US$1 million) and Egypt.

4.21 Under the inter-ministerial framework, the inclusion of Customs and the Central Bank is most critical. These two agencies bear responsibility for key aspects of the program's implementation, and the expeditious processing of imports, exports, and foreign exchange is vital to the success of an IFZ program.

4.22 The primary disadvantage of an inter-ministerial regulatory body is that the large number of participating ministries and agencies tends to slow the responsiveness of the agency. Because these committees contain high-level, busy officials, time constraints seldom permit them to engage in a thorough study of important issues. In addition, outside officials sometimes lack the knowledge or interest to make effective contributions.

4.23 The strength of inter-ministerial committees is that they can reduce the opportunities for power struggles between government bodies. When each ministry or office has an equal voice, none can profess to have been excluded from the approval process. However, this equality can inhibit the opportunity for exercising the strong leadership necessary to effectively implement the regime and meet the needs of the investors.

4.24 **Single ministry frameworks.** The third option, placing the authority for regulating the IFZ regime within, or under the tutelage of, a single ministry, is sometimes hampered by inter-ministerial quarrels and conflicts over bureaucratic responsibility. Given that the cooperation of multiple agencies and individuals is essential for the program's success, the vesting of authority in a single office, while effective for rapid decision-making, is seldom accompanied by the requisite inter-agency communication and broad-based support for the program to ensure that such decisions are effectively executed.

4.25 **Autonomous public sector bodies.** Nearly every IFZ program purports to offer a one-stop-shop to investors. In practice, such offices may have little power and instead represent an <u>additional</u> step in a non-coordinated investment approval procedure (as in Mauritius). Not surprisingly, working one-stop-shops are preferred by investors because the information, paperwork, and authority are concentrated in one agency. There are autonomous, public sector regulatory bodies which function in this manner. For example, in Hong Kong and Tunisia, investment approvals take less than one day and one month, respectively. Each of these agencies have incorporated automatic approvals or default mechanisms. In Tunisia, no authorization is required for firms that export 100 percent of production. In Hong Kong, companies are simply registered with the government authorities and can begin operations immediately. Default mechanisms are present in the laws of Morocco and Togo to accelerate approval in those countries in under 30 days. However, unless a government has a relatively efficient bureaucracy, this type of system may not give the host country the level of control to which it is accustomed.

4.26 **Autonomous corporate models.** Similar to the autonomous public sector models described above, autonomous corporate models are regulatory bodies comprised of a majority of private sector representatives. Established as corporations, corporate models are financed by the government but dominated by private sector personnel. This is the model that is currently being established in Togo and Cameroon.

4.27 The great strength of this configuration is that the organization is more likely to understand the needs and problems of IFZ developers and firms. As such, these organizations often work more efficiently. The prime drawback of this model is that governments are often unwilling to give this measure of authority to the private sector. The main reason for this reluctance, apart from the desire to retain control, is the potential conflict of interest that can arise. While clearly the private sector as a whole will benefit from the establishment of an IFZ program, some individual local businesses could be hurt by the enactment of the program through higher wages or the sale of new products in the domestic economy. If properly structured, however, these risks can be reduced.

b. Core Functions of IFZ Regulatory Agencies

4.28 IFZ regulatory agencies undertake a wide variety of tasks, but core functions include designating zones, approving investor applications, monitoring compliance, resolving problems, compiling statistics of IFZ growth, and identifying opportunities for future policy enhancement. In addition, regulatory bodies have commonly conducted two other tasks: promotion of the IFZ program, and development and management of zones. The ability of regulatory bodies to effectively accomplish these latter tasks varies from program to program. The Corporacion de la Zona Franca (CZF) in Costa Rica, the General Authority for Investment and Free Zones in Egypt, and the free zone authorities in Liberia and Senegal, for example, have been unable to promote or develop zones effectively.

4.29 On a structural level, these organizations have lacked the autonomy necessary to compete with private sector zone developers and promoters effectively. In terms of personnel, they have lacked the promotional and real estate experience required to undertake sound promotional efforts and real estate projects such as IFZs. This deficiency has partly resulted from the limited private sector representation in these organizations, and the lack of familiarity with the needs of private sector firms. The importance of a strong private sector voice cannot be underestimated; this is especially true in socio-political environments where the relationship between the public and private sectors is strained.

2. Administrative Procedures

a. One-Stop-Shops

4.30 One of the principal objectives of an IFZ regime is to simplify the investment process for export firms. To the greatest degree possible, the procedures for application and approval should be streamlined and clearly stated. There should be no unwritten or assumed criteria or requirements applied in an ad hoc manner. The application criteria and procedures for IFZ users should be relatively simple; those for IFZ operators will be relatively infrequent and may require greater scrutiny. Similarly, application forms should be short and concise.

4.31 Ideally, all the important incentives and regulatory measures governing export industry are bundled into one package, under the auspices of a single governing agency. In such cases the investor must make only a single application to a single institution, and will ideally receive a reply within a very short period of time. Many countries claim to have a one-stop approval process, but in practice, few do. While the incentives packages are often very similar, as seen above, it is the efficiency with which investors can access those incentives that usually distinguishes successful IFZ programs.

4.32 There is almost always a direct relationship between the institutional oversight of the IFZ regime, as discussed above, and the efficiency of the IFZ user application procedures. Institutions that are truly autonomous in their administration and oversight of the free zone program are more likely to have a streamlined application process. By contrast, in programs where authority and responsibility for the program is diffused throughout the government, the time involved to receive approval is likely to be greater. In Uruguay, for example, where the Free Zones Authority has no power to approve applications and investors must get separate approvals from the other offices of government, application approval can take as long as two months.

b. Customs Procedures

4.33 Traditionally, governments have a fundamental right to control or prevent the transfer (that is, the "entry" or "importation") of merchandise into their countries for three basic reasons:

- to protect local industries;
- to collect revenue; and,
- to obstruct the entry of undesirable merchandise.

Government authorities usually establish the geopolitical borders of the nation as the boundary over which merchandise cannot cross without government permission; these boundaries establish an area which is known as the "Customs territory" of the country. Any merchandise which enters this Customs territory from outside (foreign) sources is subject to the control of the government and the assessment and collection of duty and import taxes, if any are due under national legislation. IFZs are defined for Customs purposes as areas declared to be "outside national customs territory." Consequently, foreign merchandise entered into these zones is not considered imported into the country's Customs territory and, therefore, not subject to duties and import taxes. In this manner, governments have established IFZs without surrendering their rights and powers to control merchandise crossing their borders.

4.34 With the elimination of the need to collect duty and import taxes on merchandise entered in zones outside the Customs territory of a country, the government's responsibilities to monitor and control such merchandise becomes significantly different. For example, as duties and import taxes are not collected, there is less need for detailed statistics concerning the quantity, description, and value of the merchandise -- the basic information which usually determines the amount of duty and import taxes. Accordingly, associated documentary requirements and procedures can be revised, and, in many cases, reduced to meet the specific needs of IFZ operations.

4.35 Similarly, because IFZ operations are generally instituted to produce merchandise for export rather than for domestic sale, local producers of similar merchandise are not subject to harmful competition, and Customs procedures to ensure domestic protection become less essential. This does not mean that there is no need for government control of merchandise entering and leaving an IFZ. Customs supervision is necessary to ensure that merchandise is truly entered into the zone and not improperly diverted into domestic commerce. Similarly, information will always be needed to identify merchandise transferred and withdrawn from IFZs.[2] However, the government's treatment of IFZ merchandise and operations should reflect the inherent differences between IFZ activity and general commerce in the regulatory procedures employed.

4.36 Typically in IFZ programs, the Customs Department maintains offices in each zone, or in the case of single factory zones, in each factory; it is usually the responsibility of the zone operator to provide such facilities. Goods are usually transferred directly to the zone from the point of entry, where they are unloaded and, if deemed necessary, inspected; exports leaving the zone are inspected at the time of exit, sealed, and then transferred directly to the point of shipment without the need for further inspection. In some zones, Customs officers are available on a 24-hour basis, seven days a week, to expedite import and export procedures. The physical location of Customs on-site serves to achieve the balance between the government's needs for control, and the need to expedite the transit of goods into and out of IFZs.

[2] The usual reasons for compiling IFZ information include: the development of statistical information to measure the economic impact of zone operations, and to assess duty, taxes, and penalties when merchandise is missing or is indeed transferred to the customs territory when allowed by law and regulations.

V. ECONOMIC FACTORS INFLUENCING THE POTENTIAL FOR THE ESTABLISHMENT OF AN INDUSTRIAL FREE ZONE IN BURUNDI

5.01 In order to assess a nation's competitiveness as a prospective IFZ site, a variety of factors must be taken into account. These include both readily quantifiable national and local characteristics -- such as labor conditions and costs, physical infrastructure, and other resource endowments -- and more subjective elements such as the political climate, the administrative simplicity of the regulatory and legal framework, and market access. The purpose of this chapter is to analyze the Burundian environment for the establishment of an industrial free zone regime in terms of its locational, economic, and other attributes.

A. OVERVIEW OF NATIONAL ECONOMIC ACTIVITY

1. Macroeconomic Climate

5.02 Under the IMF- and World Bank-supported structural adjustment program, the GRB has introduced a number of economic reforms which have substantially improved Burundi's macroeconomic climate and prospects for exports. These include achievement of a realistic and flexible exchange rate, deregulation of import licenses, the rationalization of import tariffs, and the establishment of duty restitution and certain export incentives. These measures have eliminated much of the import substitution bias previously protecting domestic industries, and the resultant growth in competition has forced many firms to become more efficient.

5.03 Despite these improvements in the macroeconomic climate, however, significant economic growth has not occurred. Although forecasted GDP growth for 1989 was 4.5 percent, only 1.5 percent was achieved, according to the World Bank, largely due to a fall in coffee prices and other agricultural-related factors. The rate of inflation has risen from 4.5 percent and 7 percent, respectively, in 1987 and 1988, to an estimated 11 percent in 1989. Furthermore, total external debt was equivalent to 71.6 percent of GDP at end-1988.

5.04 Moreover, the GRB remains highly reliant on coffee earnings as a source of revenue; coffee exports in 1988 still accounted for 82 percent of total foreign exchange earnings. The vulnerability of agriculture production to adverse weather and the recent slump in world coffee prices, underscore Burundi's continued economic vulnerability; overall, the terms of trade for Burundian exports declined by 16 percent in the 1984-88 period. Furthermore, the collapse of the International Coffee Agreement augurs badly for future improvements in coffee prices. Finally, traditionally low levels of savings and domestic investment have left the country with few immediately viable areas for expanded economic growth and diversification.

2. Current Levels of Manufacturing Activity

5.05 Burundi's economy remains predominately agricultural in nature. The share of gross domestic product (at factor cost) held by industry was an estimated 4.9 and 4.8 percent, respectively, in 1987 and 1988. The total number of jobs created in the sector in the 1984-87 period amounted to only 5,720 -- a small number for an estimated 60,000 new annual entrants to the labor market.

5.06 Capacity utilization levels in most industrial sub-sectors remains low. The 40 companies surveyed by the Ministry of Commerce operated at only 50 percent of installed capacity, on average, over the 1981-89 period. A number of companies are currently producing near or even above capacity -- FAD (insecticides), SAVONOR (soaps), QUAIMI (Thread), and COTEBU (cloth) -- are all exceeding total capacity levels. Nevertheless, the average rate of capacity utilization for industry as a whole was only 52 percent in 1989, and only 17 firms of the firms surveyed exceeded 50 percent.

5.07 Burundi's private industrial sector is both small and weak. There are an estimated 557 registered companies in the industrial sector in Burundi, but the majority of these firms are engaged in commerce or services; there are only 107 incorporated firms in the manufacturing sub-sector.[1] For much of the period since independence, government policy dictated a strong governmental role in the economy. In late 1970s, for example, 87 percent of the total investments in the industrial sector were made by public enterprises. This trend has been reversed, however, as the public sector's share of investment in the industrial sector fell steadily through the 1980s, and accounted for only 11.8 percent of total investment in 1985 (the last year for which such data are available). Nonetheless, the private sector's share of total fixed investment is still only 15 percent, and the previously predominant economic role played by the government is a major factor explaining the private sector's current weakness and relative inexperience.

5.08 A further indication of the weakness of the private manufacturing sector is measured by its small contribution to total exports -- only 2.6 percent of total exports in 1988 (although this is a considerable improvement over the 0.9 percent share achieved in 1984). Extra-regional private sector exports are virtually non-existent. The private sector's share of regional exports, however, has grown from 26.3 percent in 1984 to 37.3 percent in 1988, but even this low level indicates that the public sector remains a strongly dominant force in Burundi's industrial sector. Moreover, the weakness of the industrial sector is further reflected by the limited backward industrial linkages that have been formed by the export sector. With the exception of linkages between the agricultural sector and textile and agro-processing sectors -- manufacturing firms remain highly reliant on imported inputs. This dependence substantially weakens the export competitiveness of local firms owing to the high transport costs associated with importing inputs.

5.09 The growth of private Burundian manufacturing activity is likely to remain slow in the near- to medium-term. It is widely acknowledged by members of government and the private sector that the Burundian

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[1] Available data on industrial enterprises in Burundi are inconsistent. The total figure used here is the World Bank's estimate based on the cross-referencing of official statistics in 1986.

private sector is neither large nor dynamic. Considerable constraints on the growth of the sector remain, including the absence of industrial tradition; limited demand for goods as a result of weak purchasing power both in Burundi and regionally; limited promotional or marketing skills; weakness of capital markets; a lack of technical skills; and inexperience with the requirements of project design or financial planning.

B. EVALUATION OF THE BASIC FACTORS OF PRODUCTION

5.10 In order to assess a nation's competitiveness as a prospective site for free zone activities, a variety of factors must be taken into consideration. The following section provides an evaluation of Burundi's basic economic factors of production -- land, labor, capital, and infrastructure -- as they affect potential free zone activities.[2]

1. Labor

5.11 Labor Policy. As of 1988, private sector employers are no longer required to hire workers through the Labor Office. The process required to terminate workers, however, remains highly structured and time-consuming. To release an employee, an employer must have first written three warning letters. As a result, some employers complain that it can take two months to two years to remove problem employees.

5.12 Female workers receive the same wages as male workers. However, female workers are not allowed to work the night shift, and, if married, must receive permission from their husband to work. (In general, Burundian light manufacturing firms employ male workers, in contrast to the concentration of female workers in light manufacturing industries in much of the world.)

5.13 Expatriate Work Permits. The process of receiving a work permit for an expatriate is relatively simple and straightforward. Work permits are granted on a one-year renewable basis and reportedly are processed in seven days.

5.14 Availability. Although no statistics are compiled on levels of unemployment or underemployment, companies operating in Burundi experience no difficulty in obtaining unskilled labor. As an example, one manufacturer noted that there are 900 candidates for each entry level job available. In contrast, the availability of technicians and management level personnel is seen as extremely limited.

5.15 Productivity. Respondents differed as to the productivity of Burundian labor. Absenteeism rates are typically under 5 percent, although a few companies have experienced absenteeism rates as high as 10 to 15 percent. Turnover rates appear to be low -- under 5 percent per year. Training periods for new unskilled workers varied according to industry sector, but Burundian workers were generally considered eager

[2] This assessment focuses on the capital, Bujumbura, because it is assumed that this is the most probable location for IFZ firms.

and easy to train. Strikes, though legal, are unheard of, and labor-management relations are generally characterized as good.

5.16 Apparel manufacturers in Burundi noted that product quality is higher than goods produced in Portugal, Morocco, and Tunisia. Nonetheless, the speed of production lags behind more industrialized nations. An apparel manufacturer pointed out that a typical Burundian worker can produce only five shirts per day versus twenty in Europe. Companies operating on a 24-hour basis stated that productivity levels on the night shift are slightly, but not exceptionally, lower than those on the day shift. The fact that most Burundians work 45 hours per week rather than 40 increases productivity levels to some degree.

5.17 Wage Rates. The Burundi Labor Code sets minimum wages for six levels of employees. While foreign investors generally prefer to operate in a country with one general minimum wage, the existence of six different categories compares favorably against other francophone countries such as Cameroon or Togo where there are dozens of categories. The lowest allowable minimum wage is FBu 160 in Bujumbura (US$0.11/hour). This rate has not changed since 1987. This rate is not commonly paid by manufacturing companies, however, except to temporary workers. Wages for unskilled workers typically range between FBu 250-400/day. A rate of FBu300/day is equivalent to US$0.21/hour. The practice of paying by a piece-rate, rather than on a salary basis, is legal but is not used in Burundi. Instead, most private sector employers give a year-end bonus based on the individual performance of the employee.

5.18 An often overlooked aspect of labor cost is a country's fringe benefit ratio; that is the ratio of fringe benefits to total salary. In Burundi, employers must provide a housing allowance (monthly minimum of FBu 600); family allowance (FBu 300 if married plus FBu 150 per child); medical benefits for the entire family; and the standard holiday and vacation periods (20 vacation days after 12 months of employment and eight holidays). A worker earning FBu 300/day with a wife and two children would cost the employer approximately 30 to 50 percent more than

TABLE 5-1
FRINGE BENEFIT RATES

Country	Rate
Jamaica	20%
Ethiopia	29%
Honduras	29%
Togo	35%
Mauritius	40%
Burundi	**40%**
Dominican Republic	45%
Costa Rica	49%

Source: Data compiled by The Services Group from various sources.

the stated base salary, depending on the type of medical coverage provided. The level of statutory fringe benefits is relatively competitive with other prospective and existing free zone locations, as seen in Table 5-1.

5.19 Combining the median wage rate with the fringe benefit ratio yields an all-inclusive prevailing wage of FBu 420/day or US$0.30/hour. This rate compares very favorably with other locations as shown in Table 5-2 below.

TABLE 5-2
PREVAILING WAGES

Country	Hourly Rate
Kenya	US$0.26
Burundi	**US$0.30**
Ethiopia	US$0.31
Haiti	US$0.58
Dominican Republic	US$0.59
Mauritius	US$0.70
Jamaica	US$0.88
Costa Rica	US$1.15
Hong Kong	US$2.62
Taiwan	US$2.88
South Korea	US$3.04

Source: Data compiled by The Services Group from various sources.

2. Infrastructure and Basic Services

5.20 A number of firms were interviewed in Burundi to ascertain the quality and reliability of electricity, water, and telecommunications services. In addition, interviews were held with utility providers to better understand the cost structures, constraints, and future developments expected in each sector.

a. Electricity

5.21 Electricity in Burundi is distributed by REGIDESO. The majority of Bujumbura's electricity supply is derived from hydroelectric sources and -- depending on the season -- 20 to 40 percent of Burundi's electricity is provided by Zaire. The system has a capacity of 36 megawatts while usage is generally in the range of 22 to 23 megawatts. Thus, the electrical system has substantial capacity for expansion and is considered adequate until 1997, even if no further investment is made. There is reportedly no problem with voltage fluctuation.

5.22 Reports of electric outages vary. While most manufacturers considered the supply of electricity sufficient, a few companies stated that cut-offs occur as often as 6 to 7 times per month in some seasons; the discrepancy between companies appears to be accounted for by differing locations within Bujumbura, as some areas are better served than others. As a result, some companies had recently purchased, or are considering purchasing, back-up generators. In general, however, one manufacturer who reported seven hours of power outages last year can be seen as more typical. According to REGIDESO, a scheduled rehabilitation of the electricity infrastructure in the old industrial quarter of Bujumbura will eliminate such problems in the future.

TABLE 5-3
INDUSTRIAL ELECTRICITY RATES
(per kwh)

Country	Rate
Kenya	US$0.03
El Salvador	US$0.05
Dominican Republic	US$0.06
Burundi	**US$0.07**
Sri Lanka	US$0.07
Thailand	US$0.07
Taiwan	US$0.09
Ethiopia	US$0.10
Mauritius	US$0.10
Togo	US$0.11

Source: Data compiled from various sources by The Services Group.

5.23 As evidenced by Table 5-3, the cost of electricity in Burundi for industrial users is competitive with other free zone sites, despite the fact that rates have just been raised to FBu 12.4/kwh. REGIDESO estimates that electricity rates are subsidized by a factor of 30 to 50 percent.

b. Water

5.24 Water is also distributed by REGIDESO. The supply of water in Bujumbura is considered excellent. At present, 80 percent of Bujumbura's water is sourced from Lake Tanganyika, 15 percent from a nearby river, and 5 percent from mountain sources. To reduce the amount of chemicals needed to purify water, REGIDESO will soon source 100 percent of the water from Lake Tanganyika. Water consumption is presently estimated at 40,000 m3/day, compared to an operational capacity of 78,000 m3/day.

5.25 Water rates, which like electricity are priced at 30 to 50 percent below cost, are highly competitive despite a recent increase, as seen below in Table 5-4. The rates are progressive, and the rate for clients using over 120 m3 in a two-month period is FBu 44 (US$0.25).

c. Telecommunications

5.26 Telecommunications service in Burundi is provided by ONATEL. At present, direct dial service is available to only 15 countries, although this number will be increased under a pending World Bank project. The quality of international service is considered sufficient to most countries, with the exception of Zaire. Telephone service to Zaire, due to Zaire's internal telecommunications problems, is often impossible

TABLE 5-4
WATER RATES
(per cubic meter)

Country	Rate
Burundi	**US$0.25**
Ethiopia	US$0.25
Kenya	US$0.27
El Salvador	US$0.32
Togo	US$0.67
Jamaica	US$0.79
Honduras	US$0.85
Costa Rica	US$1.18

Source: Data compiled by The Services Group from various sources.

(mail delivery is similarly difficult, with delays of 6 to 8 months not uncommon). As a result, manufacturers doing business with Zaire must conduct all business in person.

5.27 Within Bujumbura, there is a network of 7,000 numbers. There is a waiting list of 3,000 names for telephone service and it was reported that installation often takes up to three months, although ONATEL claims that businesses have first priority and typically can establish service in three days. The cost of installation is extremely low at FBu 2,000 (US$11.43). Local service is not of the same quality as that for international phone calls. To remedy this situation, ONATEL is in the process of converting from an analog to a numeric system. This changeover will be completed by October of this year, and should improve local phone service significantly.

5.28 International phone calls are expensive but are comparable to the rates found in other African countries, as seen in Table 5-5 below. A one-minute phone call to Belgium costs FBu 440/minute (US$2.50), while a one-minute call to the United States costs FBu 660/minute (US$3.77). Regional rates vary considerably, depending on whether the call is routed directly or indirectly (via Europe). The cost of a call to Rwanda, for example, ranges between FBu 211-712/minute (US$1.21-4.07), depending on the routing used. Calls made indirectly are more expensive, but the quality of the line is higher.

d. Land/Construction

5.29 There are no restrictions on the foreign ownership of land. Land prices, however, are set in Decree No. 100/8 of February 5, 1982. Land in the Industrial Quarter sells for FBu 150/sq.m. (US$0.85/sq.m.) which is highly competitive versus land prices in other countries. This price is approximately one-tenth of the land purchase price in Togo, and one-quarter of the cost of industrial land in Central American countries such as El Salvador and Costa Rica.

TABLE 5-5
TELEPHONE RATES
(per minute)

Country	Rate
Mauritius (to France)	US$1.60
Costa Rica (to the US)	US$1.68
Kenya (to the UK)	US$1.69
Burundi (to Belgium)	**US$2.50**
Togo (to France)	US$2.68
Ethiopia (to Italy)	US$3.75
Taiwan (to the US)	US$3.95

Source; Data compiled by The Services Group from various sources.

5.30 Estimates given for the construction of Standard Factory Buildings (SFBs) varied widely, ranging from FBu 25,000-45,000/sq.m. (US$142-255/sq.m.). At the low end of this range, these costs compare favorably with the costs of construction in other countries, as detailed in Table 5-6, although they compare unfavorably at the higher end of the range.

3. Transportation

a. Ocean/Surface Freight

5.31 Burundi's geographical position is clearly one of its greatest constraints to development. As a landlocked nation, Burundi suffers from not only higher transport charges but substantial delays in receiving and sending shipments. As a result, companies that import their raw materials are often required to stock large inventories, thus complicating cash flow management and limiting profitability.

5.32 Burundi is served by three transportation corridors. The Northern Corridor consists of all traffic that passes through the port of Mombasa and traverses Kenya, Uganda, and Rwanda before reaching Burundi. The

Central Corridor serves all goods and materials that pass through Tanzania. The Southern Corridor links Burundi to Southern Africa via Lake Tanganyika and, at present, is primarily used to transport bulk goods such as cement, sugar, and flour into Burundi.

5.33 Before 1988, the majority of Burundi's imports were transported on the Northern Corridor from Mombasa, due to the fact that the port of Dar-es --Salaam was considered one of the world's least efficient ports, while Mombasa was rated as one of Africa's best. In recent years, however, there has been a dramatic shift in transit traffic in East Africa. Traffic transiting through Mombasa dropped 40 percent in the 1981-88 period, while the transit traffic using Dar nearly tripled in the same period.

TABLE 5-6
CONSTRUCTION COSTS
(per sq.m.)

Country	Cost
Sri Lanka	US$120
Mauritius	US$131
Costa Rica	US$160
El Salvador	US$170
Senegal	US$217
Togo	US$250
Ethiopia	US$300

Source: Data compiled by The Services Group from various sources.

5.34 This shift has occurred for a number of reasons. First, the cost of surface transport from Mombasa is approximately 30 percent higher than on the Central Corridor, due to higher port charges and the strength of road transport lobbies in Kenya. Second, cumbersome Customs arrangements, labor problems, border delays, police escorts, and transit bonds have made the Northern Corridor more expensive and more difficult from an administrative perspective. Burundi's four transit agencies are particularly bothered by the fact that Mombasa follows a policy of 100 percent verification and thus checks each incoming shipment -- including sealed containers. The breaking of the seals, naturally, increases the amount of pilferage. As a result, nearly all containers destined for Burundi are now shipped through Dar es Salaam rather than Mombasa. While corruption exists in both ports, transit operators in Burundi note port authorities are more corrupt in Kenya.

5.35 Dar es Salaam has recently benefitted from a US$100 million infusion of funds for a new container terminal, new equipment, and refurbished cargo berths. Geographically, Dar is the more advantageous port for Burundi because only one border must be crossed on the Central Corridor as opposed to three on the Northern Corridor. The Central Corridor, however, is plagued by other constraints. Most importantly, the roads connecting Dar and Burundi are of a much lower standard than those between Mombasa and Burundi. Only one quarter of the route from Dar is paved (to Dedoma), and passage is extremely difficult in the rainy season. A second constraint is that no private shipping agents are allowed to operate in Dar, and public shippers have proven to be notoriously unresponsive. Thus, if there is a mistake on a shipping document in Dar, the goods or materials could be held up for 15 days; in Mombasa, a similar problem might be cleared up by a private shipping agent in one day.

5.36 Shipments between Antwerp and Mombasa or Dar typically take 20 to 25 days. The time needed to transport goods and materials inland is much less predictable and depends on a number of factors. The processing of the shipment through Customs in both Dar and Mombasa averages 3 to 4 days although longer delays in both ports are not uncommon. The trip by road

TABLE 5-7
TOTAL TRANSPORT COSTS, BURUNDI TO EUROPE

	Bujumbura-Dar	US$1,800	Bujumbura-Mombasa	US$2,400
	Dar-Antwerp	US$1,650	Mombasa-Antwerp	US$1,650
		--------		--------
TOTAL BUJUMBURA-ANTWERP		US$3,450		US$4,050

Source: Data provided by various transport agencies in Burundi.

from Mombasa to Bujumbura generally requires 10 days. On occasions when Kenyan Customs escorts the goods, the passage can be as long as 1.5 months owing to the delays incurred as a result of changes in police escorts as departmental boundaries are crossed. The transportation of goods from Dar to Bujumbura ranges between 5 to 15 days in the dry season; in the rainy season, the road becomes nearly impassable. On average, shipments being transported between Bujumbura and Antwerp take 2 to 3 months, with the fastest possible time being 1.5 months.

5.37 The difficulty of the transportation between Dar/Mombasa and Bujumbura is evidenced by the fact that the cost of shipping is higher between Bujumbura and East African ports than it is between East Africa ports and Europe. The rates in Table 5-7 above are based on a 20-foot container filled with textiles (rates are equivalent for incoming and outgoing goods).

5.38 As shown in Table 5-8, with the additional cost of land transport necessary, Burundian freight costs to industrialized markets are much higher than any other country hosting, or considering, a free zone program. In fact, the Burundian cost is 38 percent higher than the second most expensive location -- Mauritius.

5.39 The lake port of Bujumbura plays a central role in regional traffic and is one of the main ports on the Southern Corridor. This corridor links Southern Africa with Tanzania, Burundi, Zaire, Rwanda,

TABLE 5-8
SEA FREIGHT RATES
(US$ per 20-foot container)

Country	Rate
Dominican Rep. (to US)	US$ 700
Honduras (to US)	US$1000
Costa Rica (to US)	US$1100
Togo (to Europe)	US$1130
Taiwan (to US)	US$1300
Kenya (to Europe)	US$1650
Ethiopia (to Italy)	US$1835
Mauritius (to France)	US$2500
Burundi (to Belgium)	**US$3450**

Source: Data compiled by The Services Group from various sources.

Uganda, and Kenya. The route is primarily used for transporting bulk products and very little container traffic exists. According to transport specialists, regional traffic functions smoothly except for traffic destined for Eastern Zaire. The route to Rwanda and Uganda is in good condition, particularly when compared to conditions in Eastern Zaire. In general, regional ports are adequately run and sufficiently equipped. Shipping time to Zambia, the furthest point, is 2 to 3 days. The cost for shipping a 20-foot container of textiles to Zambia is approximately US$1100.

b. Rail Transportation

5.40 Unfortunately, the railroad between Dar and Kigoma, the Tanzanian port on Lake Tanganyika, does not provide a better alternative for surface transport. The railroad was built in 1905 and is considered antiquated while the number of wagons and locomotives is insufficient. Passage is difficult in the rainy season as portions of the track are submerged under 20 cm. of water. Shipping agents complain that there are ten different handling points on the railroad versus 3 to 4 for cargo shipped by truck. Passage of goods by rail takes 3 to 4 days, followed by 1 to 2 days by boat to Bujumbura. Pilferage is reportedly a problem in Kigoma. In addition, the crane in Kigoma is not large enough to handle some containers and therefore many goods -- such as coffee -- must be shipped in bulk. As a result, Burundi's highest grade coffee is now shipped by truck, despite the fact that rail transport is 50 percent less expensive.

c. Air Freight

5.41 There are currently six flights per week connecting Burundi to Western Europe: Sabena has four flights per week while Air France has two. Sabena's freight capacity averages 35 tons per flight although capacity increases to 50 tons on direct flights. In addition, Sabena typically has one dedicated cargo flight per week. As demand warrants, Sabena is ready to increase its number of flights and cargo capacity. The rate for shipping textiles to Brussels on Sabena is FBu 30/kg. (US$0.88/kg.) which makes air freight relatively competitively vis-a-vis existing or potential African free zone programs.

5.42 Sources noted that air freight service was generally of high quality, although occasionally space is not immediately available. The handling procedures at the airport are considered adequate and Customs procedures are reasonable, with the delay experienced for cargo averaging 30 minutes.

TABLE 5-9
AIR FREIGHT RATES
(per kg.)

Country	Rate
Jamaica (US)	US$0.24
Honduras (US)	US$0.32
Costa Rica (US)	US$0.46
Dominican Republic (US)	US$0.62
El Salvador (US)	US$0.79
Burundi (Belgium)	**US$0.88**
Togo (France)	US$1.56
Mauritius (Europe)	US$1.72
Ethiopia (Germany)	US$1.85
Senegal (France)	US$2.82
Sri Lanka (UK)	US$2.90
Taiwan (US)	US$7.10

Source: Data compiled by The Services Group from various sources.

4. Capital

a. Capital Requirements of IFZ Firms

5.43 The financing requirements of export firms vary greatly according to the nature of the industrial operation. While heavy industrial operations have large recurrent demands for financing to manage inventory and to cover working capital costs, most light manufacturing operations have less substantial funding needs. For typical IFZ light manufacturing firms, capital equipment requirements tend to be modest, since inputs are often not purchased but are shipped on consignment. and all output is "sold" to the parent company.

5.44 Nonetheless, the financing requirements of exporting firms, whether foreign- or domestically owned, can be significant. Adequate funding is necessary at all stages of the investment and exporting process in order to provide:

- pre-investment financing to undertake required feasibility studies, market research, and trial production runs prior to shipment;

- medium or long-term equipment financing to purchase machinery and other goods required for production;

- import financing for imports of goods used in the production process; and

- export financing and insurance for shipments of goods which are not paid for by letter-of-credit.

In addition, exporting firms often have greater short-term financing needs than do other types of firms because the greater transport times can delay the receipt of payments.

b. Burundi's Financial Sector

5.45 Burundi's financial sector includes 7 banks and 11 non-banking financial institutions. The banking institutions include the Burundi Central Bank, the Banque de la République du Burundi (BRB); 4 commercial banks (Bancobu, BCB, ABB, and Meridian Bank); and 2 development banks (BNDE and SBF).

5.46 Lending practices in Burundi, as in most developing economies, are conservative in nature. All bank loans require some form of collateral. For new borrowers with no established borrowing record at a bank, typical collateral requirements represent 100 percent of equity. This practice severely reduces access to credit by small and medium firms. Furthermore, this restriction of credit is worsened by current practices which have made banks reluctant to accept land as collateral. Burundian social norms have made courts reluctant to enforce the transfer of land from borrowers to banks, even in clear cases of default. Furthermore, a recent change in the mortgage law, which gives government first claim on land held as collateral in cases where the owner has a tax liability to the government, has also reportedly heightened banks' reluctance to accept land as collateral.

5.47 Similarly, lending tends to be short-term in nature. An estimated 85 to 90 percent of commercial banks' loan portfolios are short-term in nature, while the remaining consists of medium-term loans for periods of 2 to 7 years.[3] Commercial banks do not provide loans longer than 7 years. As in most African countries, the undeveloped state of Burundi's financial markets means that there is no form of forward cover available

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[3] Contrary to standard practice elsewhere in the world, short-term credit in Burundi is defined as up to two years (versus up to one year elsewhere); medium-term credit is defined as 2 to 7 years (versus 2 to 5 years); and long-term, over 7 years (versus 6 to 7 years).

to guard against exchange rate fluctuations. The lack of such cover raises the potential cost of operation to exporters owing to potential losses due to currency fluctuations.

5.48 The level of domestic savings in Burundi is very low, thereby constraining the total amount of funds available for lending. Overall, an estimated 90 percent of all investment capital in Burundi is of foreign origin, reflecting the very low levels of domestic savings. In the 1984-87 period, domestic savings were equivalent to an average of only 4.7 percent of GDP at market prices. While this level rose in 1988 to 9.9 percent, it is still low relative to many other African countries.[4] Government and public sector borrowing have absorbed much available credit, thereby reducing the financing available for lending to the private sector. In 1988, lending to government and the public sector absorbed 62 percent of the loans made by the two development finance institutions, and 44 percent of the loans by commercial banks.

5.49 Two financial facilities have been established to improve the availability of credit in Burundi. These are the Fonds National de Garantie (FNG) and the APEX facility. The FNG was established in 1988 to insure high-risk loans or loans without sufficient collateral. As of mid-year 1989, the FNG had 17 loans in the pipeline, providing a modest total risk coverage of approximately FBu 18.5 million (US$104,000). APEX is a line of credit financed by the World Bank to provide financing for small and medium enterprises. The loan ceiling under this line of credit is set at US$300,000. APEX's start-up was slow, however, owing to the participating banks' lack of familiarity with the program's procedures. Furthermore, utilization of the APEX credit has been proven problematic, owing to fundamental weaknesses in project design in the loan applications submitted -- a further sign of the weakness of the private sector.

c. PTA Trade and Development Bank

5.50 The Burundi-based Preferential Trade Area (PTA) Trade and Development Bank is another potential source of credit to exporters. Trade financing services by the bank include such as activities as confirming letters of credit and pre-shipment finance in order to support regional trade. Project lending gives priority to projects which promote or create intra-PTA trade; utilize PTA raw materials, inputs, and expertise; generate economic benefits such as foreign exchange savings or earnings; or have the potential to benefit more than one member country.[5]

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[4] For example, domestic savings averaged 18 percent for Mauritius, 20 percent for Kenya, and 15 percent for Zambia.

[5] The other signatories to the PTA treaty are: Angola, Comoros, Djibouti, Ethiopia, Kenya, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Rwanda, Somalia, Swaziland, Tanzania, Uganda, Zambia, and Zimbabwe. Botswana and Seychelles are members of the PTA but have not yet signed the treaty.

5.51 To date, however, the trade financing services of the bank have been the more significant area of operations, although it appears that Burundi has not yet benefitted from these services. Under the bank's pre- and post-shipment scheme, US$4 million in funds each have been disbursed to Ethiopia, Kenya, Uganda, and Zambia; Malawi and Zimbabwe have received US$3 million and US$5 million, respectively. The bank also operates a letters-of-credit confirmation scheme which, through arrangements with overseas banks, enables importers to buy supplies without paying for them up-front. To the extent that Burundi takes advantage of these schemes, the availability of such services could help some potential exporters gain needed resources to obtain necessary inputs. It should be noted, however, that the bank's letter-of-credit confirmation scheme does not apply to intra-regional LCs, and thus could be of assistance only to exporters obtaining inputs from outside of the PTA region.[6]

d. Implications for Enhanced Export Activity

5.52 The availability of financing for export-oriented activities can be an important catalyst or constraint to expanded export production. The lack of short-term credit was the most commonly cited obstacle facing local firms. Further impediments appear to include a lack of venture capital; the conservative lending practices of local banks; legal procedures which inhibit the use of land as collateral; and high collateral requirements generally. These all represent significant constraints on future lending to export-oriented firms.

5.53 In Burundi's case, the most probable investors in the export sector in the short- to medium-term will be local investors unable to draw upon the financial resources of parent firms. Thus, the availability of local credit may be more important to the ultimate success of an industrial free zone regime than would be the case in other developing countries. In this light, the above-mentioned constraints represent a potentially significant barrier to the success of a Burundian IFZ regime.

5.54 While the FNG and APEX loan schemes offer the potential to assist some firms, the effectiveness of these programs will be critical to the viability of such an export-oriented regime. Furthermore, these programs are aimed at small- and medium-sized enterprises. For larger firms unable to access these programs, the credit problems identified above still apply, and further financial sector reforms will be necessary. Indeed, two of the most dynamic exporters in Burundi interviewed by the TSG team were too large to borrow under these schemes; as a result, owing to the lack of long-term credit, one of these firms was forced to pay cash for its equipment.

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[6] Intra-PTA LCs go through the PTA Clearinghouse, rather than the PTA Development Bank.

5. Assessment of the Competitiveness of Burundi's Economic Factors of Production

5.55 The proximity, quality, and cost of infrastructure, transportation, and labor are vital components determining the success of a free zone program. The relatively high costs of many developing countries' basic factors of production, coupled with poor quality, has proven to be an insurmountable obstacle in some zone programs. In terms of the cost of water, electricity, telecommunications, air freight, and labor, Burundi is fairly competitive with other existing and developing free zone centers. On the other hand, Burundi is handicapped by the unreliability and high cost of surface transportation to developed country markets.

5.56 The quality and reliability of water, electricity, and telecommunications services, while leaving room for improvement, provide an adequate level of service for free zone activities. Pending improvements in the telecommunications sector should help make Burundi's competitive position stronger.

5.57 The prevailing wage rate, despite Burundi's slightly higher than average fringe benefit ratio, is one of the country's strongest comparative advantages. It remains to be seen if Burundian labor is competitive, however, on the basis of productivity.

5.58 Overall, the constraint posed by the high cost of surface transportation is tremendous. Regardless of Burundi's strengths in the other factors of production, the high cost of transportation effectively limits Burundi's free zone potential to the regional market and to goods with high-value to low-weight ratios that can utilize air freight. But the regional market, as will be discussed in further detail below, offers little purchasing power and remains a poor substitute to industrialized country markets. Based on the economic factors of production, it is evident that the greatest potential for the development of manufactured exports from Burundi rests in sectors utilizing air freight.

6. Other Factors

5.59 In addition to the basic factors of production, there are other factors that potential free zone investors take into account when considering alternative free zone investment sites. These include such variables as the political climate of the country, the quality of life for expatriate staff, and the country's social stability. These are non-quantifiable factors, but they are also very important -- a nation's shortcomings in this area can deter foreign investors despite the country's economic resource endowment or the existence of an attractive package of incentives.

5.60 Burundi has a number of these non-quantifiable factors to its credit. In particular, the country is characterized by a very pleasant climate, with an attractive capital and a wide variety of recreational opportunities. Similarly, the quality of housing available to expatriates is very high, crime is not a problem, and there are no curfews or other such security problems that might deter foreign investors. Businessmen reported themselves largely content with the current business environment and operating conditions.

5.61 Unfortunately, however, there are a number of negative factors which might outweigh these positive attributes in the eyes of foreign investors. Many foreigners' perception of Burundi's investment climate may be colored by their knowledge of past outbreaks of tribal violence and by the level of acquired immune deficiency syndrome in the region. Moreover, owing to its small size, Burundi is not well known internationally. These factors, combined with the high cost of transport, may limit Burundi's competitiveness in attracting foreign investors.

5.62 In the final analysis, however, none of these subjective factors -- either positive or negative -- in and of themselves decisively influence foreign investors. They serve as a reminder, however, that a country's investment climate is comprised of a myriad of factors and that governments must actively remove deterrents to export sector growth on a variety of fronts if they are to be successful.

C. POTENTIAL MARKET FOR BURUNDIAN GOODS AND SERVICES

1. Market Access and Preferential Trade Areas

a. Developed Country Markets

5.63 The growth of offshore manufacturing, and the geographic and sectoral composition of trade, has been influenced to a great extent by the regimes governing trade between industrial and developing countries, and particularly those applying to specific sectors. Overall, the effect of international trade agreements has been arguably positive, due to the impact of a number of preferential regimes for imports from developing countries. At the same time, however, the industrial countries have maintained and even increased protectionist barriers restricting LDC access to their markets for certain raw materials and manufactured goods. The principal trade agreements governing trade between industrial and developing countries which apply to Burundi are summarized below.

Lomé Convention. Beneficiaries of the Lomé Convention agreements receive preferential treatment for manufactured exports to the European Community (EC) for products manufactured from materials originating in a member ACP (African-Caribbean-Pacific) state or in the EC. The duty- and quota-free access to the EC market guaranteed under Lomé III has been extended under the recently signed Lomé IV agreement. Free access is also granted to some products which contain non-ACP or non-EC sourced materials, if such materials do not account for more than five percent of the total material costs and if certain types of processing have been carried out. Sufficient processing is generally defined to have occurred if it produces a product with a different tariff heading.

Under Lomé IV, the rules of origin -- to determine whether an article is actually made in an ACP country -- have been simplified and made more lenient. Moreover, signatory states can receive exemptions from the normal rules governing products of mixed origin if they have added 45 percent to the good's value, as long as the importation of the good into the EC does not create a market disturbance. This represents a relaxation of the 60 percent value-added requirement under Lomé III.

The Convention guards against misuse of duty-free access by non-ACP countries seeking to avoid trade tariffs or other entry restrictions. Thus, the simple assembly of non-originating parts to make a complete item, or the repackaging of items, does not constitute sufficient processing to qualify for duty-free entry, even if it results in a different tariff heading.

European Generalized System of Preferences (EC/GSP). This program of the European Economic Community offers duty-free treatment of processed goods from most developing countries, providing that they meet a local value-added requirement of 40 percent. In 1988, total exports from developing countries under the EC/GSP exceeded US$20 billion, an increase of more than nine percent over the previous year. Under the program, EC-sourced materials can be combined with locally sourced goods to satisfy the minimum value-added requirement of the scheme. The allowable items under the program are quite extensive, including such "sensitive" goods as textiles, apparel, footwear, steel and petrochemical products.

In addition, there are two U.S. preferential trade agreements, the U.S. Generalized System of Preferences and Provision 9802 of the U.S. Harmonized Tariff Schedule. While Burundi's exports are eligible to qualify tariff relief under these programs, is not realistically anticipated that the United States holds much potential for Burundian exports owing to the long distance between the two countries and the concomitantly high cost of transport.

b. Preferential Trade Area (PTA)

5.64 As a signatory to the Preferential Trade Area Treaty, Burundi also benefits from favorable access to the markets of other PTA member countries. Signed in 1982, the treaty did not become operational until July 1984 with the initiation of tariff reductions on intra-PTA trade. Its membership is comprised of 20 Eastern and Southern African states with a total population of some 180 million.

5.65 The provisions of the treaty are quite broad, encompassing an integrated program for promoting the economic development of the region as a whole, with the goal of achieving self-sustained economic development. From a market access perspective this translates into the reduction of tariff and non-tariff trade barriers solely among these nations. Import tariff reductions are presently being phased in at a biennial rate of 10 percent until 1996, with a goal of eliminating tariffs entirely by the year 2000. A program has also been put in place to simplify and harmonize Customs procedures and documentation requirements of the member nations.[7]

5.66 Numerous other measures in support of economic growth have also been launched over the past five years to ensure that members of the regional business community have access to the technical, financial, and promotional assistance they require to successfully undertake regional trade. For example, efforts have been launched in support of regional trade promotion (information dissemination, trade fairs, promotional publications) and a federation of regional chambers of commerce has been established to promote investment.

5.67 The establishment of the PTA Clearinghouse in 1984 was designed to facilitate regional trade by enabling the use of national currencies in the settlement of day-to-day transactions among member states, thereby requiring the use of convertible currencies only when settling net balances between countries; this exchange is carried out by the region's Central Banks every 2 months. According to an official at the PTA Trade and Development Bank, an estimated 14 to 15 percent of all intra-PTA payments now utilize the Clearinghouse, up from an estimated 10 percent in 1988. According to the Central Bank of Burundi, the Clearinghouse mechanism operates smoothly.

5.68 Under the PTA Treaty, more than 300 products qualify for preferential tariff treatment ranging from 10 to 70 percent, according to product category and as determined by PTA provisions regarding the rules of origin. As originally drafted, the PTA allowed only products produced by firms with at least 51 percent local ownership to qualify for any benefits under the treaty. In May 1986, this requirement was replaced with a sliding scale, as follows:

- 51 to 100 percent local ownership receive 100 percent tariff relief;
- 41 to 50 percent local ownership receive 60 percent tariff relief;
- 31 to 40 percent local ownership receive 30 percent tariff relief; and
- 30 percent and below do not receive any tariff relief.

5.69 In addition, the c.i.f. value of the imported materials used in the production of goods exported under the PTA cannot exceed 60 percent and the local value-added component must account for at least 45 percent of the ex-factory cost.[8] These rules of origin requirements limit the attractiveness of the PTA program as a stimulus for foreign investment in a Burundian IFZ. For the most part, foreign-owned IFZ firms' ownership structure and production processes are likely to disqualify them from utilizing the program at a meaningful level. For local manufacturers, however, the benefits offered under the program may

[7] PTA Customs procedures are discussed in greater detail in Chapter 6.

[8] The requisite level of required value-added varies for some goods determined to be of particular importance to Member States.

provide a significant market advantage, depending on the composition of their production inputs and processes.

5.70 Although the PTA has begun implementing its program of tariff reduction, progress has been slow, and the original deadline for achieving the first level of cuts had to be delayed owing to a failure by most members to implement the reduction in time. While there is general agreement on the importance of tariff reduction, and there has been some genuine progress towards this end, it is likely that the process will continue to advance slowly, thereby hampering the expansion of intra-regional trade. Moreover, much work remains to be done on the elimination of non-tariff barriers to trade. Thus, while the PTA market is a potentially large one, only 10 percent of total trade by the member countries currently occurs on an intra-regional basis.

c. Communauté Economique des Pays des Grands Lacs (CEPGL)

5.71 The CEPGL Accord was signed in 1976 between Burundi, Rwanda, and Zaire with the chief economic objective of promoting commercial exchanges and the free circulation of goods and persons between the three nations. Zaire is not a member of the PTA, and the tariff reductions of the PTA agreement do not apply to Burundi-Zaire trade. A series of tariff reductions on manufactured products have been accepted in principle, however, by the three members of the CEPGL, although they have not yet been implemented.[9]

5.72 Under a Monetary Accord signed in 1987, trade between the CEPGL member country states is paid for in local currency (provided the goods has at least 25 percent value-added), both in order to facilitate trade and limit the drain on scarce hard currency resources. Thus, a Burundian exporter, for example, who sold goods to Zaire would receive payment in Burundian francs, facilitated by transfers between local banks. Every three months the Central Banks of the three countries balance accounts, thereby limiting the use of foreign exchange solely to settle the difference between trading accounts.

2. Current Trade and Investment Patterns

5.73 As the GRB has stressed in its Five-Year Plan and in other policy documents, Burundi's current trade with the rest of the world operates under a number of well-documented handicaps: the country's geographical position, which raises transport costs; an over-reliance on coffee exports as the principal source of foreign exchange earnings; and a small manufacturing sector and a heavy reliance on overseas markets for consumption goods and imports of machinery and spare parts. As a result of these problems, Burundi has suffered from an average annual negative commercial balance throughout the 1986-88 period of FBu 10 billion.

5.74 To help overcome these problems the GRB in recent years has introduced a number of policy and institutional measures to encourage expanded exports. In addition to the strong emphasis on export

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[9] Zaire was invited to join at the 1989 PTA Heads of State meeting.

development in the Five-Year Plan, these have included the introduction of a new duty drawback system for exporters; establishment of an inter-ministerial commission to coordinate export promotion activities; establishment of the Comité Permanent de Promotion des Exportations; creation of the Agence pour la Promotion des Echanges Exterieurs (APEE); and the convocation of an export promotion seminar.

a. Trade with Industrialized Countries

5.75 Europe is Burundi's principal trade partner for both exports and imports, accounting for 54.8 percent of all imports and 83.8 percent of all exports in 1988. Finland and West Germany alone absorbed 57 percent of all exports in that same year, while West Germany, Belgium, and France provided 75 percent of imports. The next largest regional trade area is Asia, primarily Japan and Iran, which accounted for 27 percent of total imports. The United States is a largely inconsequential trade partner, accounting for less than one percent of exports and less than 2 percent of imports in 1988.

b. Regional Trade Patterns

i. Exports

5.76 Burundi's exports to neighboring countries within the region have risen steadily in terms of both value and volume in the 1984-88 period, as shown in Tables 5-10 and 5-11. Although data on changes in the value of exports need to be treated cautiously due to the distortive impact of currency movements over time (particularly the devaluation of the Burundian franc), data on the quantity of exports in Table 5-11 show that the total volume of exports has more than doubled in the 1984-88 period. Not surprisingly, owing to their geographic proximity, exports by volume to Zaire and Rwanda showed the greatest increase, 318 and 263 percent, respectively; exports to Zimbabwe also registered a substantial increase of 700 percent in the same period, but beginning from only a negligible base.

5.77 Despite this overall growth, however, total exports to all other African countries still accounted for an average of 7.5 percent of Burundi's total exports over the 1984-88 period.[10] Exports to Burundi's two key trading partners, Rwanda and Zaire, accounted on average for only 4.4 percent of total exports in this period.

5.78 Moreover, as can be seen in Table 5-12, despite the overall improvement in both the volume and value of exports, Burundi's overall commercial trade balance with African countries was consistently negative over the 1984-88 period. Among countries in the immediate region, Rwanda is the only country with which Burundi has had a consistently positive trade balance in this period, although exports to Zaire exceeded imports in 1987-88.

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[10] Excluding 1987 when it rose to 18 percent.

TABLE 5-10
BURUNDI'S EXPORTS TO REGIONAL MARKET, BY VALUE, 1984-88
(million FBu)

	1984	1985	1986	1987	1988
Total Africa of which:	964.6	1075.9	1342.5	2028.3	1432.8
Zaire	199.4	173.8	268.6	325.5	577.2
Tanzania	33.0	129.9	22.2	33.4	43.2
Kenya	427.1	202.0	246.4	366.7	155.5
Rwanda	176.1	381.6	377.7	613.8	515.5
Zambia	4.0	--	--	6.6	--
Uganda	47.3	63.9	419.3	601.0	4.6
Zimbabwe	--	27.8	8.2	81.7	137.0

Source: BRB
-- negligible

TABLE 5-11
BURUNDI'S EXPORTS TO REGIONAL MARKET, BY QUANTITY, 1984-88
(tonnes)

	1984	1985	1986	1987	1988
Total Africa of which:	5985.0	5826.0	9977.0	16664.0	14973.0
Zaire	2798.0	799.0	5522.0	6362.0	8904.0
Tanzania	22.0	884.0	252.0	751.0	1542.0
Kenya	1690.0	1330.0	1415.0	2795.0	856.0
Rwanda	1104.0	1785.0	1683.0	4548.0	2948.0
Zambia	25.0	--	--	23.0	--
Uganda	39.0	235.0	1101.0	1803.0	15.0
Zimbabwe	--	154.0	4.0	382.0	708.0

Source: BRB
-- negligible

TABLE 5-12
BURUNDI'S REGIONAL TRADE BALANCE, 1984-88
(million FBu)

	1984	1985	1986	1987	1988
Total Africa of which:	-1867.4	-1364.6	-1521.6	-641.1	-2381.5
Zaire	-97.0	-78.0	-152.4	205.7	296.8
Tanzania	-471.0	-123.1	-193.4	-82.5	-167.4
Kenya	-330.5	[illegible]	-400.7	-291.9	-649.9
Rwanda	95.7	363.6	364.7	605.9	511.9
Zambia	-421.9	--	--	-1032.3	--
Zimbabwe	-411.4	-251.5	-148.5	-148.4	-315.0
Uganda	47.3	63.9	419.3	601.0	4.6

Source: BRB
-- negligible

5.79 Table 5-13 summarizes the chief Burundian exports in 1988 by product and end-market country. The table illustrates that Burundi's exports within the region are overwhelmingly directed to Zaire and Rwanda; with the exception of cigarettes, cotton cloth, and batteries, no single official manufactured export had an external market greater than two countries.[11] By total value, the four most important export products are bottles (FBu 325.0), cotton cloth (FBu 262.9), cigarettes (FBu 194.6), and beer (FBu 125.7). As a sign of the narrowness of Burundi's export manufacturing sector, only four companies -- VERRUNDI (bottles), BRARUDI (beer), COTEBU (cloth), and BTC (cigarettes) -- accounted for 70 percent of all manufactured exports in 1988. It should be noted that these statistics no doubt understate total exports, if unofficial exports to the region were to be counted. COTEBU, for example, officially exports 10 percent of its total production, but company officials estimate that an additional 40 percent of the firm's total output is unofficially exported by local traders.

[11] The products listed in Table 5-13 include 100 percent of official exports to Zimbabwe, Uganda, and Tanzania; 99 percent of all exports to Zaire; and 90 percent of all official exports to Rwanda.

ii. Re-exportations and Transit

5.80 From a regional perspective, the level of goods which enter and exit Burundi as re-exportations or items in transit are also very

TABLE 5-13
BURUNDI'S CHIEF REGIONAL EXPORTS, BY PRODUCT, 1988
(million FBu)

	Zaire	Rwanda	Tanzania	Kenya	Uganda	Zimbabwe
Total by Country: of which:	577.2	515.5	43.2	24.7	4.6	137.0
Beer	115.5	--	10.2	--	--	--
Milled Rice	50.2	0.6	--	--	--	--
Cigarettes	33.0	--	--	24.6	--	137.0
Fibro-cement Panels	5.5	29.1	--	--	--	--
Plastic Items	40.7	--	--	--	--	--
Cotton Cloth	190.4	72.1	--	--	0.4	--
Glass Bottles	94.3	230.7	--	--	--	--
Metal Items	20.4	4.3	--	--	--	--
Batteries	0.5	73.4	--	--	4.2	--
Bottle Caps	--	55.9	--	--	--	--
Bottled Drinks	20.7	--	--	--	--	--
Animal Food	2.2	--	33.0	--	--	--

Source: BRB
--: negligible

limited. Re-exportations are goods which enter Burundi and which are then resold to another customer in another country. Transit goods are goods which simply traverse Burundi, sealed in containers and without paying duties or taxes, on their way to another country; for example, merchandise from Zambia bound for Rwanda.

5.81 According to the BRB, approximately 80 percent of transit goods are destined for eastern Zaire. The primary types of goods are basic necessities such as motor fuel, pharmaceutical, and electrical items from Kenya; practically all the motor fuel used in eastern Zaire originates in Kenya. Transit goods from southern Africa bound for Rwanda are chiefly sugar and cement. The total value of transit goods passing through Burundi in 1988 and 1989 was only FBu 2.9 billion and FBu 2.7 billion, respectively (approximately US$16.7 millon and $15.3 million, respectively).

5.82 The total level of re-exports in 1988 and 1989 was FBu 39 million and 130 million, respectively (US$226,000 and $746,000). Similarly, the chief end-market was Zaire, which accounted for an estimated 88 percent share of all reexports. Rwanda accounted for most of the remaining share, while single cases of re-export went to Uganda and Tanzania. Construction materials and vehicles were the primary types of products.

5.83 By contrast, the total value of goods which were essentially transshipped through Aruba and Curaco without paying duty, was US$65 million and $95 million in 1988. Similar shipments through the Miami Free Zone in the United States totalled $US1 billion in that same year.

c. Trends in Foreign Investment

5.84 Total levels of direct private foreign investment have historically been weak, averaging only US$1.1 million per annum over the 1980-86 period. The GRB could not provide data to the study team on the levels of foreign investment in recent years, but the Chamber of Commerce has stated that only 3 to 4 foreign investors have invested in Burundi in the last several years. At least one of these, BUMINCO, is a mining company, not a manufacturing enterprise.

3. Implications for a Burundian Industrial Free Zone

5.85 Given the above discussion of Burundi's comparative economic endowment, certain basic conclusions can be drawn regarding the industry sectors with the highest export potential. Burundi's geographical position and the high cost of land transport effectively limit the nation's export potential to two categories: those products with high value-to-weight ratios, which can be profitably shipped by air freight to Europe, and those products for which there is substantial regional demand.

5.86 The reliance on air freight places Burundi at a substantial competitive disadvantage vis-a-vis other IFZ countries. As seen above, freight rates per ton are on average much lower for sea freight than for air freight. Owing to the competitiveness of international markets for such commonly produced free zone products as apparel and shoes, an estimated 75 percent of free zone firms rely on sea freight in order to reduce costs; air freight is usually limited to high fashion goods where seasonal demand and higher value-added makes the increased transport cost worthwhile. Similarly, most electronics components are shipped by air, but as discussed in Chapter 3, it is unlikely that electronic assembly operations will be attracted to Burundi as such operations seldom locate in newly established free zone countries; moreover, the movement of electronics firms offshore is slowing.

5.87 Currently, the only product manufactured in Burundi that has some potential for export to Europe, both in terms of quality and cost-competitiveness via air freight, is garments. According to a report prepared by AMEX International, 99 percent of the cotton fiber produced in Burundi is first rate fiber, and the cloth produced by COTEBU is similarly of an extremely high quality.[12] Although it is a bit heavy for high fashion garments, it is suitable for other industry sub-sectors. One firm (NAB) has already successfully exported clothing to Europe, while one other is planning to do so (SIRUCO). Textile exports to Europe would qualify for preferential tariff treatment under the Lomé Agreement.

5.88 Of the remaining manufactured products that are currently exported regionally, however, as cited in Table 5-13 above, none appear to have the quality, suitable value-to-weight ratio for shipment by air, or adequate market demand to be exported to Europe. Moreover, based on the historical growth pattern of other IFZs worldwide, investments by computer or electronics firms (goods which can be shipped by air freight) are not at all probable in Burundi. Owing to the technological sophistication of such industries, the rapidly changing nature of their markets, the higher operating capital costs, and their more specialized facilities' needs, such firms are not typically investors in new IFZ sites, but prefer well-established ones.

5.89 The potential for regional exports is somewhat better. A World Bank study in 1988 compiled estimated "comparative advantage indices" comparing Burundian industrial competitiveness with that of Kenya and Rwanda. Although the study was based on very limited data, it concluded that Kenya was Burundi's most significant competitor in all neighboring markets, but that good prospects existed for increased exports of cotton and other textiles, construction materials, metallic manufactures, food products, and furniture, notably to Zaire and Uganda.

5.90 Nonetheless, the prospects for regional trade are not overwhelming. While a number of persons interviewed by the TSG team voiced the opinion that Burundi's land-locked position was an advantage because it made the country a center for the region, it is dubious that prospects for vastly augmented regional exports are realistic. There are a number of negative factors which militate against such an expansion. While the regional population is large, the buying power of these neighboring countries is limited, and can be expected to grow only to the extent those economies are characterized by economic growth and sound economic management. Through the 1980-87 period, however, the economic growth rate of the six, geographically closest countries -- Kenya, Tanzania, Zaire, Rwanda, Uganda, and Zambia -- averaged a negative 0.7 percent, while annual rates of inflation averaged 36 percent. Even to the extent that economic growth and management improves in these countries, the average per capita GNP is only US$245, thereby representing a sharp constraint on the potential for export growth.

5.91 Furthermore, many of the basic items that Burundi currently produces and exports are also produced in these other countries, thus effectively depriving Burundi of any natural market niche. Progress has been slow to reduce tariff and non-tariff barriers in the region, and the complementarity of production activities between the PTA and CEPGL countries makes this process more difficult. COTEBU, BBI, Eternit, and Cogetraff were among the companies interviewed who cited protectionism

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[12] AMEX International, "Export Enhancement Program: Republic of Burundi," prepared for USAID, Burundi, December 1, 1989.

and tariff barriers as significant impediments to their efforts to export to Rwanda, Zaire, and Zimbabwe.

5.92 Finally, the current low volume of goods in transit and re-exported goods indicate that the total volume of commerce naturally passing through Burundi is quite low; again, probably reflecting the limited regional purchasing power, as well as the existence of a variety of alternative transit routes to regional markets. The minimal transit activity indicates limited potential for substantial commercial warehousing operations. This conclusion is further supported by the fact that current Burundian law allows the establishment of private entrepots, exempt from duties, for goods destined for reexport. The current practice is very similar to a commercial free zone regime, and the fact that it has fostered so very little trade is a strong indicator that the regional market and trade levels are insufficient to support a successful commercial warehousing program.

5.93 These factors do not mean that further regional export growth is not possible and cannot be encouraged, but that expectations should be extremely modest regarding the use of regional exports as an engine of significant economic growth. There is no IFZ program operating in the world in a land-locked country, and there is only one IFZ program that produces primarily for a regional market; that of Senegal, which has attracted only 6 firms after 15 years of operation. Both the international cost competition between IFZ countries, and the purchasing power of developed country markets makes the successful establishment of an IFZ regime under such locational and market limitations extremely difficult. In the face of such substantial competitive disadvantages, any proposal to create an IFZ in Burundi must carefully weigh the potential cost of such a program against the limited benefits that it is likely to bring.

VI. ASSESSMENT OF THE BURUNDIAN LEGISLATIVE, INSTITUTIONAL AND REGULATORY ENVIRONMENT

6.01 This Chapter reviews the current export regimes in place in Burundi, analyzes administrative procedures affecting exporters, and examines key institutions which may be called upon to administer a prospective IFZ regulatory body.

A. ASSESSMENT OF EXISTING EXPORT REGIMES

6.02 There are essentially two separate regimes governing export-oriented firms in Burundi: the Investment Code Law of 1987 (No. 1/005) and the Export Promotion Decree-Law (No. 1/012) of April 15, 1988, and its subsequent amendments. The incentives granted to exporters under each regime are examined below.

1. Investment Code

6.03 Burundi's Investment Code was revised in 1987. Under the Code, particular attention is paid to the following types of companies:

- companies which produce for export;
- companies using local materials;
- companies with a high labor-intensity;
- small and medium enterprises;
- handicraft producers; and
- companies located outside of Bujumbura.

6.04 The Code establishes four separate investment regimes: the "Régime de Droit Commun," the "Régime des Enterprises Prioritaires Agréées," the Régime des Entreprises Conventionnées," and the "Régime des Enterprises Décentralisées." These four will be discussed in turn, but of these four regimes, the Régime des Enterprises Prioritaires is the one most directly applicable to export-oriented enterprises, and will be examined in the greatest detail.

6.05 **Régime de Droit Commun**: This regime applies to all firms, foreign and domestic, and confers no special benefits or incentives. It sets forth all obligations regarding the establishment of a business, registration procedures, etc.

6.06 **Régime des Enterprises Conventionnées**: Companies qualifying for special incentives under this regime must fulfill certain economic or social objectives. Industrial firms must either create at least 100 new jobs, or invest at least FBu 1 billion (US$5.7 million). Agriculture or agro-industrial businesses must create at least 150 jobs or invest at least FBu 500 million (US$2.9 million). Firms meeting one of these two requirements benefit from incentives which, in addition to those accorded to firms qualifying as Enterprises Agréées (discussed below), include an agreement to stabilize direct taxes, especially revenue taxes, for a period of up to 10 years.

6.07 **Régime des Enterprises Décentralisées**: Firms locating outside Bujumbura receive a reduction in income tax from 45 to 35 percent, following a period of exoneration; subsidized water and electricity costs; improved credit terms; and are allocated free land.

6.08 **Régime des Enterprises Prioritaires Agréées**: Export-oriented firms and firms investing in the agricultural, industrial, artisanal, tourist, and transport sectors can qualify as priority industries under this regime. New companies qualifying for incentives under this regime must invest a minimum of FBu 20 million (US$114,000), or must be expanding existing operations by at least FBu 15 million (US$86,000). Furthermore, to be considered as priority industries, companies must fulfill a number of conditions, including:

- ensure that financing and technical capacity is guaranteed;
- recruit and train Burundians;
- stimulate the diffusion of technology;
- contribute to an improvement of the balance of payments;
- contribute to the fulfillment of the Plan.

6.09 The fiscal advantages available under this regime can include:

- total or partial exoneration for up to 8 years of profit, personal, and land taxes;
- for projects which need more than 4 years to mature, total or partial exemption of import taxes on equipment and primary materials, for a period not to exceed 5 years; and

In addition, exporting companies can receive exoneration of duties and taxes on exports, exoneration of import taxes on equipment, exoneration of import taxes primary materials for a renewable 5-year period, and restitution of Custom import duties through the use of the duty drawback program.

6.10 These incentives are negotiated on a case-by-case basis, in relation to the size of the investment and the project's anticipated effect on the national economy. While the incentives granted are often generous, and are similar to many of the incentives available under a typical IFZ regime, this discretionary element -- that is, the lack of automaticity -- is the Code's greatest weakness.[1]

2. Export Promotion Decree-Law

6.11 The key piece of legislation governing the export sector is the Export Promotion Decree-Law of April 15, 1988. This law seeks to increase the administrative simplicity of export procedures, while also granting fiscal incentives to exporters of manufactured products or fabricated handicrafts. The central provisions of the law include:

- elimination of export taxes for qualified exporters;

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[1] Chapter 4 discusses the types of incentives common to IFZ programs worldwide.

- reduction of corporate income tax levels by one-half for income received from export sales, thus lowering the current effective level to 22.5 percent for exporting companies;
- creation of a new, revised drawback program which allows exporters to receive refunds of all Custom duties and fees on imported inputs used in the manufacture and packaging of goods destined for export;
- restitution of transaction taxes on imported inputs and packaging destined for export manufacture through a system of tax credits;
- assurance that foreign exchange will be made available for the importation of needed goods and services, within limits set by the BRB;
- deduction from corporate income tax payments of the costs of business trips, information-gathering, and other costs associated with export activities, up to a fixed limit; and
- establishment of a preferential regime for the transfer of expatriate salaries and dividend payments.

6.12 The Decree-Law was subsequently amended by three ministerial ordinances issued later that same year. These modifications were introduced to clarify the decree and to aid in its implementation. The major modifications included:

- Exporters of traditional goods -- coffee, cotton, tea, raw hide, gold, live animals, and mineral products -- cannot benefit from the incentives offered under the Decree-Law.
- Deductible business expenses are limited to 10 percent of gross export value, with a maximum level of FBu 2 million (approximately US$114,000) for exporters established less than one year.
- Refunds under the drawback program are made automatic and are set at 10 percent of the value of the exported goods.

6.13 The duty drawback program is the key export incentive mechanism under the law. The current drawback scheme revised and replaced a previous drawback program that was so inefficient that it was not uncommon for companies to wait 5 to 7 years to receive refunds.

6.14 Under the revised program, companies producing for export receive a refund of Customs tariffs and service taxes paid on imported inputs. The exporter submits 3 documents to Customs: the declaration of goods imported, showing the value of the imported items; the declaration of exportation form; and the form requesting restitution of duties paid. Customs reviews these forms to verify the importation and exportation of the goods in question, and then directs the Central Bank to issue a refund equivalent to 10 percent of the value of the imported items. Refunds currently take about 14 days to be issued.

6.15 Under an amendment to the Decree-Law (Ordonnance No. 650/202), refunds are automatically made which are equivalent to 10 percent of the value of the exported goods. Under the revised tariff system, imported primary and intermediate inputs typically fall into the 10 percent tariff category; thus, this is the level that is automatically refunded.[2] Customs later reviews the documentation in detail and determines the actual tariff category applicable to the imported inputs. The firm is then either assessed duty owed for the difference, or is paid an additional refund. Companies interviewed that are currently utilizing the drawback scheme expressed satisfaction with the program's operation.

6.16 Although the drawback program commenced in 1988, the first registered exporters were not approved until July 1989, and the program has not really begun to be utilized until this year. Although an estimated FBu 250 million (US$1.4 million) was budgeted last year for the program, and an estimated FBu 500 million (US$2.86 million) in this year's budget, there are still few firms taking advantage of the program. In the first 6 months of 1990, only 12 companies received drawback restitution, amounting to a total of FBu 69.3 million (US$396,000). Moreover, use of the program is heavily skewed to several firms; only 3 firms -- Exim, Cogetraff, and Capco -- accounted for over 70 percent of total restitution issued in this period.

6.17 A number of reasons account for the underutilization of the program. The first months of the program's operation were plagued by difficulties because the initial procedures were too complex; a shortened approval process was adopted in August 1989. Moreover, according to Ministry of Commerce officials, a number of companies had been skeptical about the efficacy of the program, owing to the excessive delays encountered in receiving refunds under the previous drawback scheme. Finally, some companies that qualified as priority or exporting industries under the Investment Code have not requested use of the drawback program, presumably because the benefits received under the Code are either equal to or exceed those received under the duty drawback program, or possibly because of the administrative burden of applying to change regimes.

3. Evaluation of Burundi's Export Regime

6.18 The parallel provision of export incentives under both the Investment Code and the Export Law is confusing. While each law offers exporters relatively attractive benefits, it is not clear how potential exporters or investors decide which law is the most appropriate policy mechanism to govern a firm's operations.[3] Moreover, under the Investment Code, incentives are not granted on a uniform basis, but are determined according to each individual application. This lack of automaticity can only serve to deter investors, especially foreign firms who have the option of investing in countries with more straightforward investment regimes.

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[2] According to the Ordonnance, this rate is to be regularly adjusted in accordance with the level of Customs duties assessed on primary materials.

[3] The otherwise excellent Guide Des Investisseurs, published by the Ministry of Planning in order to assist investors, discusses both regimes in a highly ineffective fashion by failing to explain the differences between the two regimes.

B. OVERVIEW OF EXISTING REGULATORY/INSTITUTIONAL FRAMEWORK AND PROCEDURES

6.19 This section assesses the Burundian regulatory and institutional environment for the development of an industrial free zone regime. Like the basic factors of production, the existing regulatory/institutional framework is critical to the ultimate success of such a regime. Many industrial free zones around the world have economically favorable basic factors of production, particularly large supplies of low-cost labor, but are uncompetitive sites for investment owing to regulatory or bureaucratic limitations. These weaknesses include such factors as constraints on the use of foreign exchange, burdensome or corrupt Customs procedures, restrictions on land ownership, or lengthy investment approval processes, among others.

1. Administrative Procedures

a. Customs Procedures

6.20 The ease with which inputs can be cleared through Customs and with which manufactured goods can be exported is a critical element of any successful export manufacturing regime. Manufacturers must be able to obtain inputs in a timely manner in order to maximize productive efficiency, and must be able to export in an expeditious fashion in order to meet sales deadlines.

6.21 Burundi's Customs procedures for clearing imports and exports are potentially cumbersome, requiring completion of seven separate steps. Companies that were interviewed, however, reported that clearance of imports usually took only one day, although there are reports that from time to time 3 to 4 days are needed. The elimination of export taxes has helped to reduce the time needed to complete export procedures. Similarly, Customs procedures for entrepots were described as relatively straightforward and timely. In the worst case scenario, when problems do occur at border crossings, the country's small size enables exporters to drive to the border to resolve any problems.

6.22 Customs inspection procedures are also relatively straightforward. All containers are inspected on-site, at the importer's factory or warehouse, where the contents are verified by a Customs Agent and member of the Police. Exporters complete a declaration of goods to be exported, and Customs makes a summary inspection to verify that the goods declared are in fact what is being exported. Normal work hours for Customs officials are from 7:00 a.m. to 12 noon, and from 2:00 p.m. to 5 p.m. Customs officials are available to work extraordinary hours at the port and airport; in these cases, an additional tariff is charged to cover overtime costs. It is the exporter's/importer's responsibility to pay these costs, which amount to FBu 200/hour/agent (US$1.15).

6.23 A common Customs procedure was introduced in January 1989 for exports and goods-in-transit between northern corridor member countries. A common "road transit Customs declaration" (RTCD) form is now employed by Kenya, Uganda, Rwanda, and Burundi; Zaire and Tanzania, while not members of the Customs accord, have also begun to use the form. This one-page document, which is certified by the Customs of the country of origin or exit, enables containers to be transported across borders without needing to be examined. These transit procedures have reduced transport time from Mombasa to Bujumbura by one-half by enabling trucks to cross borders on weekends, when Customs officials work on reduced schedules.

6.24 The operation of this system in Burundi is reportedly even more efficient than in other PTA countries. Burundi is the only participating country which does not require the placement of a deposit to ensure that no leakage of goods occurs while the goods are in transit. According to one transport company, Burundian Custom procedures are so simple and straightforward that Burundi is the only country in the region where the firm feels it is not necessary to have an expediter at the border to ensure that trucks can cross without delays.

6.25 Importers and exporters interviewed by the study team uniformly expressed satisfaction with the efficiency, honesty, and timeliness of Customs officials and procedures. Based upon similar TSG interviews with private sector companies in other African countries, this lack of complaints or criticism is essentially unprecedented. Substantial reform of Customs procedures and operating practices is usually required in nearly all developing countries seeking to establish industrial free zones. In Ethiopia, for example, Customs delays commonly range from 2 to 4 weeks, while in Kenya, 2 to 3 week delays are not uncommon. The apparent efficiency of the Burundian Customs force is a very strong asset in Burundi's efforts to increase export manufacturing, and the planned computerization of the Customs service within the next year should further strengthen Customs' efficiency.

b. Foreign Exchange Regulations and Repatriation of Capital Policies/Procedures

6.26 The Banque de la Republic du Burundi (BRB) has control over all foreign exchange transactions and foreign trade in Burundi. Within the past several years foreign exchange procedures have been eased and made more efficient, but the BRB still retains relatively strict control over the use of foreign exchange. All exports and imports require licenses, with the exception of trade with PTA and CEGPL countries; no foreign exchange controls are necessary for these countries for qualifying products owing to the existing compensation mechanisms.[4]

6.27 As a result of a recent liberalization, applications for import licenses can now be submitted to authorized banks. These banks have the power to approve allocations of foreign exchange which do not exceed FBu 10 million (US$57,000); allocations above that level require authorization by the BRB, as do imports of certain goods.[5] By enabling

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[4] Products meeting minimal value-added requirements require no export licenses.

[5] These include imports of used machinery or vehicles; imports which threatened the monopolies of certain governmental parastatals (COTEBU, VERRUNDI, ONAPHA, AND BRARUDI), although this practice is due to be phased out by the end of 1990; and

commercial banks to process import licenses, the average time needed to receive foreign exchange has fallen from 2 weeks to 1 to 4 days. It is not always necessary to receive an individual import license for each shipment. Global licenses may be issued which allow importers to import several shipments under the same license, up to a specified level. On some occasions, applications have been returned and importers have been directed to negotiate a lower price or to procure the goods elsewhere; in 1989, for example, the BRB directed importers to obtain cement from PTA countries only. A fee equivalent to one percent of the value of the goods is assessed to cover administrative costs, and an additional service tax equivalent to 4 percent ad valorem is also assessed.

6.28 In order to ensure inward remittance of export proceeds, any export with a value exceeding FBu 10,000 (US$57) must receive an export license. All foreign exchange earnings from exports must be surrendered within 8 days of their receipt.

6.29 A number of restrictions exist on the transfer of earnings abroad. Expatriates working in Burundi are allowed to transfer abroad up to 50 percent of their net annual income. Similarly, not more than 50 percent of the return on foreign capital and emoluments and dividends paid to resident foreign directors and auditors can be transferred abroad; 100 percent can be transferred in the case of nonresidents. The remainder can be transferred at a set scale over the next 5 years, and the interest earned over that period is also transferable. These restrictions do not apply, however, to firms that received special preferential status under the Investment Code. Fifty percent of net rental income earned by foreign owners of new industrial or commercial buildings can be transferred abroad (after deduction of 20 percent for maintenance expenses), and the remaining 50 percent can be transferred two years later.

6.30 Residents may apply for foreign exchange required for overseas travel. There is no set maximum amount, but rather the amount that can be allocated depends on the destination and nature of travel. Only non-resident expatriates or companies may have foreign exchange accounts.

c. Investment and Other Approval Procedures

6.31 The Commission Nationale des Investissements (CNI) in the Ministry of Planning is responsible for reviewing investment applications.[6] Applications submitted to the CNI must contain the following information:

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imports of cement, computers, vehicle parts, and petroleum products, among others.

[6] The Ministry of Planning presides over the CNI, whose members are comprised of representatives of the Ministries of Commerce, Agriculture, Finance, Labor, and the Ministry which would have oversight responsibility for the potential company; the Governor of the Central Bank; the Director-General of the Center for Industrial Promotion; and representatives from the bank or institution financing the project and the Fonds National de Garantie.

- market and technical studies;
- initial and permanent working capital;
- development costs;
- annual turnover;
- total amortization;
- personnel costs for local and expatriate employees;
- total tax revenue to be generated;
- projected cash flow;
- plans for reinvestment or extension of the project;
- capital requirements;
- break-even point;
- probable level of value-added;
- job creation;
- internal rate of profitability, both before and after taxes; and,
- the likely gains in foreign exchange resulting from increased exports or import substitution.

6.32 According to the Ministry of Planning, this information should cover 10 years at a minimum in order to enable the assessment of the project's advantages for the national economy. In addition to a complete application, of which 15 copies must be submitted, these additional documents must also be presented:

- agreement in principle that financing has been arranged;
- pro forma bills for the required inputs and primary materials; and,
- incentives requested.

In addition, the following documentation may also be required: authorization from the Ministry responsible for overseeing the sector in which the proposed investment is to be made, and authorization from the Direction Générale de l'Urbanisme.

6.33 In order to streamline the investment process and reduce the investment application review period, the 1987 Investment Code abolished the Commission Technique des Investissements, and gave authority in this area to the CNI, which was directed to meet at least one time every two months. The Ordonnance d'Agrément, which applies to companies qualifying for investment incentives under the Régime de l'Agrément, should be signed no later than 3 months after each meeting of the CNI.

6.34 According to the Ministry of Commerce, however, it can often take 5 to 6 months for new investments to receive investment approval and to be granted incentives under the Investment Code. Applications are submitted initially to the CNI for examination. The CNI then submits the application, along with CNI's recommendations, to the Conseil de Ministres. Under previous practice, investments could be expedited to some extent by the fact that the CNI apparently had the power to approve investment proposals, and to award incentives to firms making investments of less than FBu 15 million (US$85,700). The Conseil was only involved for investments above that amount. Procedures have now evidently changed, and account to some extent for the lengthy delays in granting investment approvals.[7]

6.35 The complexity of the investment process is illustrated schematically in Figure 6-1. In essence, all sectors of government are involved in the approval process through their representation on the CNI. Additionally, the institutions having a specific function include the Minstries of Planning, Finance, and Justice; the CNI; and the Conseil des Ministres.

6.36 For companies that are already established in Burundi, but are seeking to be classified as exporting companies in order to receive incentives, the approval process is less lengthy, but is still cumbersome. Firms wishing to be established as an exporting company must submit to the Ministry of Commerce the following documentation. These include:

- photocopy of the business license;
- photocopy of certificate showing affiliation with the Chamber of Commerce and Industry;
- photocopy of the property registration;
- documentation of the firm's physical assets, including location of the building site, dimensions of the buildings, etc.;
- evidence of the firm's financial balance, attested to by an accountant; and,
- completed application form stating final markets, product(s) to be exported, buyer's address, etc.

6.37 The amount of time needed to approve the applications examined by the study team showed that approval times ranged from 6 weeks to 2 months; the Ministry of Commerce indicated that 6 weeks was fairly indicative of the average time needed for approval. Approval can take longer, of course, if applications are incomplete or inaccurate when filed.

6.38 While the revision of Burundi's Investment Code was intended to streamline the investment process and make the country a more attractive site for private investment, investment procedures remain cumbersome and overly lengthy. The necessary time needed for approval, whether for new investors or for companies wishing to receive investment incentives, compare very unfavorably to approval times in leading IFZs worldwide, where approvals are often granted in less than 30 days.[8]

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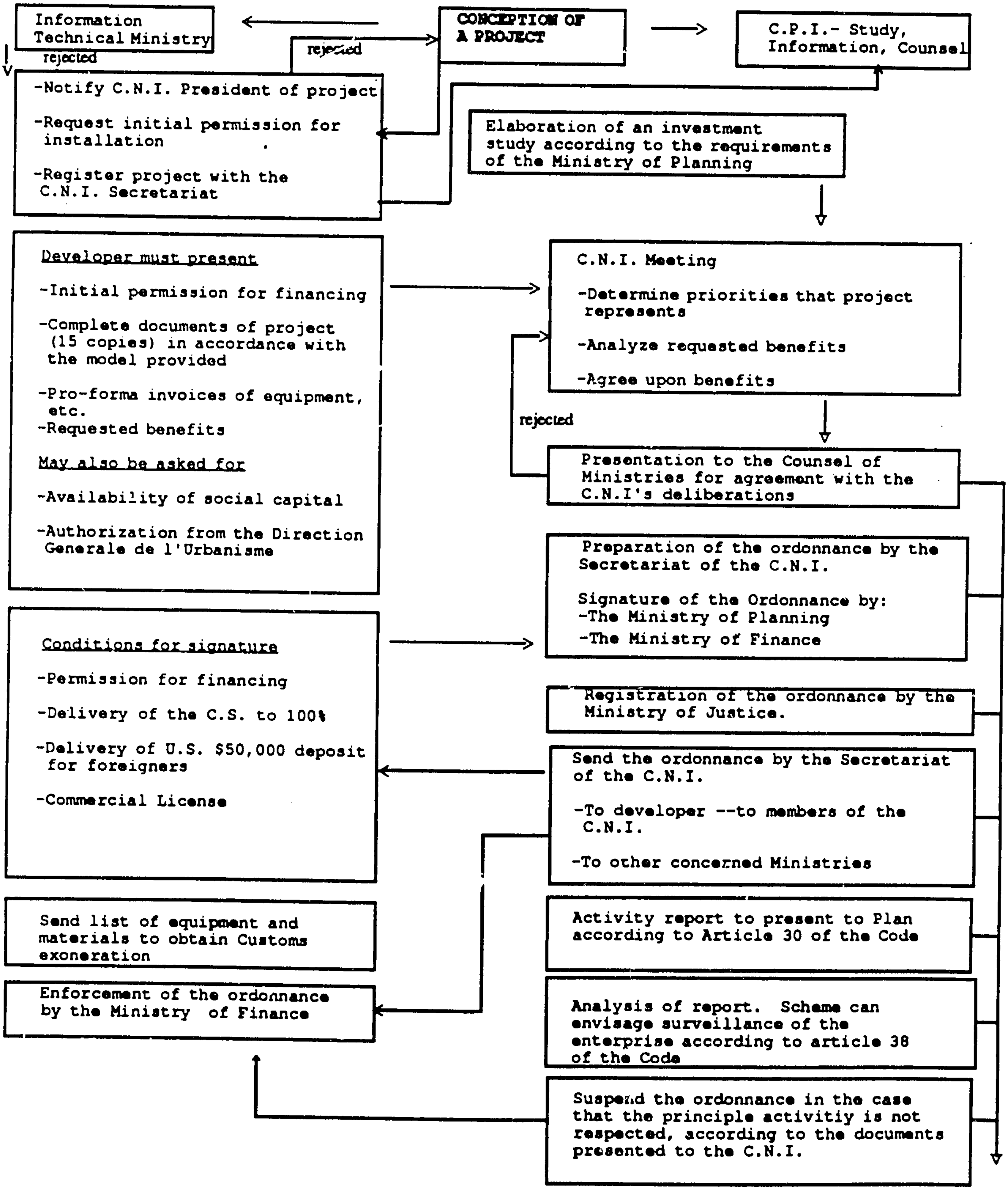
[7] As of late 1989 this practice was continuing, as identified in the World Bank report, Doing Business in Burundi, September 1989.

[8] Figure 4-1 in Chapter 4 compares the number of days required for investment approval under several IFZ programs in the world. This chapter also provides a detailed discussion of application procedures, approval times, etc. in leading IFZ countries worldwide.

FIGURE 6-1

ADMINISTRATIVE PREPARATIONS AND PROCEEDURES OF A PROJECT IN ACCORDANCE WITH THE INVESTMENT CODE



Source: Ministere du Plan, Guide des Investisseurs.

6.39 Moreover, the documentation requirements are more complex than those found in most IFZs. This is particularly true for investments made under the Investment Code. Typically under IFZ regimes, investment applications do not require complex technical or financial feasibility studies; the appropriate authorities will seek to determine that no criminal or other misrepresentation has been made, but the ultimate burden of financial success or failure is left to the firm.

6.40 Similarly, successful IFZ programs usually have a single, short application form, often only 5 to 6 pages in length, which requests only basic and summary information on the firm and its proposed operations. The information required is standard for all potential IFZ firms and does not vary according to circumstance. As with the incentives offered under the Investment Code, as discussed above, Burundi's investment procedures are complicated and confusing in their administration. Furthermore, the need for some the information requested is doubtful; for example, why must investors be members of the Chamber of Commerce? Ideally, investment legislation should seek to include as wide a variety of permissible investors as possible, rather than establish arbitrary or unnecessary procedural barriers which may preclude new investment.

6.41 Finally, another weakness of Burundi's investment regime is the lack of any centralized agency to direct or advise potential foreign investors. The Ministry of Planning is the chief agency overseeing investments, however, there is no centralized office or organization for the promotion of foreign investment. While there is a Center for Industrial Promotion within the Ministry of Commerce, this agency appears to be primarily responsible for promoting the development of industry in Burundi and for preparing studies of potential industrial projects. Officials at the Ministry of Commerce did not characterize this agency as being involved in direct investment promotion. Nor, as will be seen below, does this responsibility fall under the aegis of existing export policy or export promotion institutions.

2. Overview of Key Institutions Overseeing Export Activities

6.42 Regulatory bodies play a key role in the efficiency with which IFZ regimes are administered and implemented. This section provides a brief overview of the key GRB institutions which are involved in varying degrees in the export sector. The project scope of work does not include a comprehensive institutional assessment, instead provides for an overview of the relative capabilities and constraints of each body.

6.43 In addition to the institutions discussed above which are concerned with investment and other procedures, there are a number of institutions which are involved to differing degrees in the oversight of the export sector. These are the Agence de Promotion des Echanges Exterieurs (APEE); the Comité Permanent de Promotion des Exportations (CPEE); the Commission Interministerielle Chargee des Exportations; and, to a lesser extent, the Burundian Chamber of Commerce, Industry, Agriculture, and Handicrafts.

a. Commission Interministerielle Chargee Des Exportations

6.44 This 15-member Commission is a policy-making body incorporating a wide-ranging representation at the most senior levels of government. The Committee is headed by the Prime Minister and is comprised of the President of the Chamber of Commerce and all leading Ministers of Government; as needed, its meetings are also supplemented by the attendance of technical experts. The Committee's role is to supervise export sector activities in order to identify obstacles faced by exporters, and to develop policies to increase the level of Burundian exports.

b. Comité Permanent de Promotion des Exportations (CPEE)

6.45 The CPEE was established by decree in 1988 to coordinate activities related to export promotion, including helping exporters establish new markets and invest in new export-related activities; serving as a liaison between private exporters and government; and coordinating efforts to promote investments in export-related activities. The institutional goal of the CPEE is essentially an organ designed to provide advice and technical assistance to the Commission Interministerielle; both groups are supposed to meet on a quarterly basis. The CPEE is headed by the Director-General for foreign commerce of the Ministry of Commerce, and is comprised of the director of APEE, representatives of the Ministries responsible for agriculture, external relations, transport, and planning, as well as the Central Bank. Other members include representatives from the Chamber of Commerce, and the industry, agriculture, and handicraft sectors.

c. Agence de Promotion des Echanges Exterieurs (APEE)

6.46 The Agence de Promotion des Echanges Exterieurs (APEE) was established in March 1990 with the objective of providing specialized services pertaining to the promotion and development of exports. This initiative came from the Inter-Ministerial Committee.

6.47 In contrast to the CPEE and the Commission Interministerielle, which are policy-making bodies, the APEE is responsible for providing concrete, pragmatic advice and assistance directly to exporters. As defined in the statute establishing the APEE, the services to be provided include such areas as:

- provision of commercial information;
- marketing and the development of markets;
- assistance in export packaging;
- establishment of trade fairs and assistance in commercial advertising;
- provision of training and advice on overseas sales and marketing techniques, export sales pricing, legal aspects of overseas sales, and financing techniques; and,
- improving quality and standards control.

6.48 Financing for APEE's operations is drawn from capital provided by stockholders; future fees earned as payment for services provided to exporters; and funds obtained from international donors, government subventions, and other gifts. The capital stock of APEE is fixed by statute at FBu 146 million (US$834,000), represented by 1,460 shares of stock distributed among 102 shareholders. Twenty percent of the shares are held by the private sector while the rest are held by government institutions and state-owned companies. This mixed public-private agency has a substantial budget of FBu 60 million (US$342,000) for its first year.

d. Chamber of Commerce of Industry, Agriculture, and Artisans

6.49 The Chamber of Commerce, which was established in 1949, was restructured in 1986 in order to better reflect its newly adopted objective of promoting the private sector. The Chamber has 8,000 members belonging to the commerce, industry, and service sectors of the economy, and has a permanent staff of 31 persons. The Chamber is not strictly an export-oriented body, although it includes exporters among its members, but seeks to represent the broad spectrum of Burundian industries.

6.50 The administration and management of the Chamber is complex, despite the adoption of new statutes in March 1989 which were designed to introduce a new structure which was both simpler and clearer. A President heads the Chamber and a 31-member Board of Directors offers administration and guidance to the Chamber's activities; the members of the Board comprise one representative of each of the 15 provinces in the country, and of each of the 16 professional sections within the Chamber. A smaller Bureau, which is comprised of the President and 5 vice-presidents chosen from the Board of Directors, serves as a core advisory group to the Board. The daily management of the Chamber is handled by the Secretariat-General, which is comprised of a Secretary-General and four directors for Small and Medium Enterprises, Regional Affairs, Interior Affairs, and Studies and Documentation. Finally, there is a 155-member General Assembly representing the Chamber's 8,000 members and which serves as a voting, authorizing body.

6.51 Funding to support the Chamber's operations comes from government subventions and from membership fees. The total budget for 1990 is FBu 40 million (US$234,000), of which FBu 15 million was provided by members and FBu 25 million from the GRB. Foreign donors have also provided assistance to the Chamber, the most substantial contributor being the World Bank which has provided US$8 million to support the multi-year APEX program to assist small and medium enterprises.

6.52 The Chamber is not strictly a private sector organization, both owing to the subsidies received from the GRB and to the fact that a number of state-owned organizations are members. There are no government representatives at the Board of Directors level, but under Burundian law, any agency which receives government funding must have government representation. Thus, two government representatives are attached to the Chamber as "commissaires aux compte."

C. EVALUATION OF THE BURUNDIAN INSTITUTIONAL AND REGULATORY ENVIRONMENT

6.53 From a procedural perspective, Burundian Customs -- both in terms of the ease with which regular Customs procedures are administered and the efficiency with which restitutions are made to companies participating in the duty drawback regime -- represents a key strength of the Burundian enabling environment for export development. The same cannot be said, however, of current administrative practices regarding investment approvals. As discussed above, the investment application process requires excessive documentation, and the review of investment applications by both the CNI and the Conseil des Ministres creates an unnecessary overlap of responsibility which is overly time-consuming. There is clearly no one-stop-shop for serving investors in Burundi, either on a procedural or a functional basis. Similarly, the time required to receive classification as an exporting company is incompatible with the GRB's stated objective of promoting non-traditional exports.

6.54 Within the current institutional framework, the efficacy with which an IFZ regime could be potentially administered is unclear. To ensure that IFZ programs are administered effectively, responsibility for administration and oversight is typically placed in a single agency or institution. Moreover, to ensure that the program is managed efficiently and is responsive to the needs of the private sector, the best such agencies worldwide are autonomous institutions; in countries such as Cameroon and Togo, the private sector holds a majority share of the seats of the board of directors.

6.55 There is no single agency or institution in Burundi which appears ideally suited to undertake such administrative responsibilities. The CPEE and the Commission Interministerielle for exports are clearly policy-making, not administrative bodies. The Chamber of Commerce is bureaucratically complex, and is not entirely private sector-oriented, because it includes state-owned organizations among its members.

6.56 Finally, APEE is characterized by a number of weaknesses that make it unsuitable as the central administrating agency of a Burundian IFZ regime. One, the APEE is also not a completely autonomous organization. Not only is its budget partially funded by the government, but the subscription of the APEE's stock was reportedly made mandatory by the government for Burundian companies. Again, like the Chamber, APEE is not truly representative of the private sector, owing to the large number of government firms which are stockholders.

6.57 Second, APEE has evidenced little dynamism in its new role.[9] Despite a substantial budget, there is no the Agency has not yet developed a long-term plan of action or a detailed budget. Lastly, APEE, as an export-promotion agency, is not well-suited for such an administrative role because there is an inherent conflict between the two very separate functions of promotion and regulation. In order to ensure that both functions are performed well, it is usually preferable to divide these two areas of responsibility between two separate agencies.

6.58 The implications of these adminis rative and institutional weaknesses for a Burundian IFZ regime will be the subject of Chapter 7.

Legally, there is actually some ambiguity about APEE's role. While the statute creating APEE enumerates a number of objectives related to export-oriented activities, it also includes a completely contradictory responsibility for the "initiation of import-substitution projects." The inclusion of such a responsibility may simply be the result of an oversight, or may reflect some ambiguity on the part of the GRB. Should APEE pursue this objective, however, it could sharply undermine its effectiveness as an export promotion agency.

VII. CONCLUSIONS AND PLAN OF ACTION

7.01 As noted in the Introduction to this study, this report's scope was extended to include a summary discussion of the viability of establishing commercial free zones and and offshore services in the Burundian context. Accordingly, the discussion below commences with an overview of the potential for these types of zones in Burundi, before addressing in greater detail the prospects for IFZ development and the recommended measures to stimulate Burundian export expansion.

A. ALTERNATIVE FORMS OF FREE ZONE DEVELOPMENT IN BURUNDI

1. Commercial Free Zones

a. Assessment

7.02 Given the proper conditions, a CFZ can play an important role in facilitating trade through the centralization of warehouse activity. In evaluating Burundi's prospects for establishing a CFZ, a number of strengths and weaknesses become evident. The good port facilities and services are comparative pluses, as is the level of port security. In addition, transportation service to Eastern Zaire and Rwanda is generally of sufficient quality to support a CFZ. On the negative side, the following constraints exist:

- The regional market is relatively small and has limited purchasing power. As transshipped goods do not qualify for preferential treatment under the PTA and CEPGL treaties (due to minimal or nonexistent value-added)[1] all purchases would have to be made in hard currency as is currently the practice for re-exported goods. However, consumers in neighboring countries, particularly Zaire, have little access to foreign currency and it can be difficult to obtain an import license in Zaire without foreign exchange. Regional trade, despite the treaties, continues to face high tariffs and non-tariff trade barriers, particularly to Rwanda.

- As discussed in Chapter 5, it is not clear that Bujumbura is a natural transshipment or break-bulk point based on current trade patterns. Both Rwanda and Eastern Zaire can import their international goods directly through Mombasa or Dar-es-Salaam. At present, only 8 percent of Zaire's imports are re-exported through Burundi, while Burundian re-exports comprise an even smaller portion of Rwanda's imports. Regional commerce is dominated by the trade of bulk goods, such as grain and cement, which are less applicable to the CFZ concept due to the fact that they are bulky, low-value goods.

7.03 Given that CFZs are normally oriented toward the distribution of consumer goods, a CFZ theoretically could deal in products from Southern

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[1] Minimum value-added ratios are stated in Annex 3, Rule 2 of the PTA Treaty and in Article 4 of the CEPGL Treaty.

and South Africa. These products could reach their destination faster than goods imported from Asia or Europe. With the exception of Zaire, however, all countries in the region have official restrictions on trade with South Africa, and until this situation changes, a CFZ in this form remains entirely theoretical. Again, the market for such a zone would also be limited due to the low levels of regional buying power.

7.04 Article 247 of Ministerial Ordonnance No. 030/187 allows for the creation of private entrepots, otherwise known as bonded warehouses. The private entrepot system is analogous to a commercial free zone in that it allows for the duty-free storage of goods. The private entrepot system functions smoothly and is used extensively by Burundian importers of consumer goods. The law allows for the establishment of entrepots on private property; approval for entrepot status is usually granted by the Ministry of Finance within 1 to 4 weeks -- a reasonable processing time by international standards. Although the goods stored are primarily destined for the Burundian market, some re-exportation of automobiles to Zaire has occurred.

b. Recommendations

7.05 Because the present private entrepot system functions well, it is unnecessary for the GRB to establish an entirely separate CFZ program given the limited potential for significant CFZ activity. However, there are modifications that can be made to improve the private entrepot system, including the following measures.

- **Introduce a single key entrepot system.** The existing entrepots utilize a double key system. Under this system, both the owner of the entrepot and a Customs official must be present to enter the site. Although Customs is highly responsive and typically comes to the site within 15 minutes, CFZs normally allow open entry as would any other shop. By eliminating the double key system, warehouses can also function as showrooms for display and inspection by purchasers. This approach is more likely to attract consumers from neighboring countries than the present system which does not encourage shopping on an informal basis. Customs can prevent the "leakage" of goods into the local market through periodic auditing and imposition of stiff fines when infractions occur, rather than through the physical control and supervision system now being used. This change would reflect the Customs practices now standard in much of the world.

- **Export licensing requirements for entrepot companies should be abolished.** While no export licenses are needed for Burundian firms exporting eligible products to PTA or CEPGL nations, companies that now use a private entrepot as a base for re-exportation are subject to export license procedures.

- **Re-exporters should be allowed to have hard currency accounts.** Export licenses are required as a means to control foreign exchange; however, as re-exports must be sold in hard currency and would generate net foreign exchange earnings, foreign exchange accounts should be permitted. The use of foreign exchange accounts would increase the competitiveness of private entrepot owners through better flexibility and heightened responsiveness to market opportunities.

- **Export taxes should also be removed from all re-exports.** While Burundi has eliminated export taxes on nearly all manufactured goods, this reform has reportedly not covered re-exports. The reported FBu 10,000 (US$57) limit on duty-free cross-border exports should be eliminated. Instead a 1 to 2 percent Customs fee should be levied, as is done in most other CFZ programs.

- **Policies need to be developed to encourage traders and consumers from neighboring countries to visit and purchase goods in Burundi.** First, road tariffs for Zairean vehicles should be lowered from the present US$62 to the nominal level paid by Rwandan vehicles.[2] Not only is this an exorbitant amount, but it is extremely difficult for Zaireans to access the hard currency required for the toll. Second, restrictions and formalities required for visas should be eased and should be available at border crossings and the airport upon request.

7.06 While the potential for re-exported and transshipped products is necessarily limited in Burundi owing to the factors listed above, the adoption of these recommendations will allow the entrepot system to function more effectively. Moreover, by adapting an existing system, rather than introducing a new program, the GRB will be able to minimize implementation costs while expanding the present system's scope.

2. Offshore Financial Services

a. Assessment

7.07 Burundi offers few of the intrinsic conditions necessary for the success of offshore financial services such as offshore banking, corporate registry, captive insurance, and maritime registry. On the positive side, Burundi shares the same time zone with much of Western Europe, thus easing business communications. On the negative side, Burundi's legal system is not based on British common law[3] and English language capability is limited. The geographic position of the country places it at a disadvantage regarding wealthy investors. Similarly, the political and social history of Burundi is likely to be seen as a strong disincentive to potential investors fearful of instability, regardless of the current situation. Although Burundi offers a high quality of life to expatriates, it would take a substantial amount of time and resources to convince potential foreign investors in the financial sector that this is the case.

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[2] As reported in the USAID report entitled "Trade Between Burundi and Zaire," by Lucie Colvin Phillips, February 5, 1989.

[3] The preferred legal system for international investors due to its treatment of financial trusts.

7.08 While Burundi does have regular flights to Europe, they are much less frequent and more expensive than flights to other tax havens serving Europe, such as Luxembourg, Gibraltar, Channel Islands, Malta, and Cyprus. Similarly, telecommunications to Europe, although of relatively high quality and reasonably priced by African standards, are not competitive with European tax havens.

7.09 While offshore financial services companies are typically excluded from doing business locally, the fact that the Burundi Franc is not a hard currency and that there are restrictions on its movement in and out of the country would be perceived negatively by many in the global financial community. In contrast, many of the tax havens -- Panama, British Virgin Islands, Turks and Caicos, and Puerto Rico -- use U.S. dollars as the national currency, and all allow for complete freedom of exchange.

7.10 Perhaps the greatest constraint, however, is the lack of privacy and security available to bank depositors. Reportedly, many public sector officials can access private bank records on demand. The BRB, police, and tax authorities can order a person's account to be debited for an amount owed, or block the account entirely. Abrupt policy changes, such as last year's drastic reduction in the amount of expatriate salaries that could be repatriated, are unacceptable, as is the seizure of the property of political opponents without filing criminal charges. Such practices are anathema to the offshore finance community which seeks a safe, secure, and private investment environment.

7.11 Burundi is likewise at a disadvantage in terms of the country's institutional capability to administer and service offshore finance industries. The Governor of the Central Bank has noted that it would be impossible for his staff to manage such a program at this time, while also managing the structural adjustment program. Moreover, Burundi reportedly has no certified accountants or corporate tax lawyers, and only one notary. As such, Burundi lacks both the institutional and private sector capacity to service offshore industries.

7.12 In analyzing Burundi's potential, it is also necessary to examine potential demand. Historically, tax havens have been oriented towards wealthy neighboring countries. Caribbean tax havens have served North American investors, while European tax havens have drawn investment from fellow Europeans. In the Middle East, Bahrain has been the focus of offshore banking activity for its oil-rich neighbors. In the case of Burundi, regional investment potential appears limited; it seems probable that wealthy African investors would prefer to continue relationships that have already been established in Switzerland, Luxembourg, and other established sites.

7.13 The potential for attracting investors from developed countries appears to be similarly limited. With its historic ties to Belgium, Burundi would naturally seek out that market. However, Belgian investors are well served by existing European havens. While changes in EC finance regulations could spur growth outside European tax havens after 1992, it is unclear what ramifications will take place. Many new entrants to offshore banking, such as Malaysia, offer significant advantages over Burundi including: sophisticated English-speaking labor forces, geographic proximity to wealthy investors, and excellent transportation and infrastructure facilities.

7.14 Owing to these factors, Burundi holds limited potential as a full-service tax haven featuring all of the following: offshore banking, corporate registry, maritime registry, and captive insurance. The potential for each of the four sectors is briefly discussed below.

b. Recommendations

i. Captive Insurance

7.15 The captive insurance industry has largely been an outgrowth of the U.S. insurance industry, and traditionally has located in well-established tax havens such as Bermuda and Barbados. Captive insurance is less developed in Europe. More recently established tax havens, such as the British Virgin Islands and the Turks and Caicos, view the development of the insurance sector as a second or third phase of offshore services, to be introduced after the successful establishment of corporate registry, primarily due to the higher level of skills and security required by this sector. As a result, this sector holds little short-term potential for Burundi and it is recommended that a captive insurance program not be established at this time.

ii. Maritime Registry

7.16 Among African countries, maritime registry has proven to be highly successful in Liberia. Liberia's program is over 40 years old, however, and competition between countries offering offshore maritime registry has become extremely fierce in the past few years. Moreover, owing to the high cost of changing ship registrations from one country to another, ship owners are also reluctant to transfer their ships' registry to new countries, thus making it difficult for new registry programs to attract ships. Both of these factors make it difficult for new countries to successfully establish maritime registry programs.

7.17 In general, maritime registry programs have not experienced the quick successes that have sometimes been experienced in corporate registry programs. The costs of regulating this sector are also higher, as registered ships must be inspected periodically to ensure conformance to certain minimum safety standards. Additional costs would also be incurred for Burundi because the establishment of a maritime registry program would require the drafting of a maritime law suitable for governing ocean-going vessels. Thus, the higher administrative costs, high competition, slower start-up, and difficulty of entry make this sector less attractive for Burundi and it is recommended that Burundi not establish a maritime registry at this time.

iii. Offshore Banking

7.18 There are basically two approaches to establishing an OBU program. The first is to adopt a laissez-faire approach and to grant licenses liberally. This approach can produce quick results as there is always room in the international marketplace for the registration of questionable or illegitimate bank activity. The levels of secrecy provided by more established centers such as Switzerland, the Bahamas, and the Cayman Islands are continually being eroded through agreements with U.S. and other government authorities to eliminate the laundering of drug money and earnings gained through other illegal activities. The decreased levels of secrecy provided by more established OBU centers has subsequently provided opportunities for less vigilant banking centers. Some countries which have adopted this approach -- such as the Cayman Islands -- have later evolved to the point where authorities can be more selective in granting OBU licenses. Such an evolution to more legitimate activities is not always easy, however; some countries which have attempted this evolution, such as Montserrat, have later faced embarrassing disclosures of widespread illegal activity. Because of the potential negative repercussions, it is recommended that Burundi not adopt this approach.

7.19 A second approach, followed by Barbados, Gibraltar, and Cyprus, is to grant licenses only to prestigious international banks after a lengthy vetting process. This approach naturally leads to much slower results in the short-term and much higher administrative expenses for the government. However, such a strategy is more likely to eliminate potentially illegal activities, and is well-suited to countries with double taxation treaties. Burundi, however, reportedly has no treaties of this type. Nonetheless, there is little hope that Burundi could attract any significant number of large, multinational banks at this time given Burundi's lack of comparative advantages. Therefore, this approach is also not recommended.

iv. Corporate Registry

7.20 A corporate registry program has a number of features that make it more attractive than other offshore service programs for the present Burundian context. Most importantly, corporate registration programs are often able to become successful within a few years. The British Virgin Islands program for example, which started in 1985, has 22,000 companies whose registration fees now account for 40 percent of all government revenue. The Turks and Caicos program registered 2,500 firms in its first three years of operation, yielding US$700,000 in annual revenue.

7.21 Of the four finance sectors, corporate registry has the most potential for short-term success for various reasons. First, a corporate registry program is relatively easy to monitor in comparison with offshore banking or maritime registry. Last year in the British Virgin Islands (BVI) for example, offshore companies provided US$4.6 million in government revenue while the cost of supervising the program was US$215,000. Second, recent experience in the BVI, Turks and Caicos, and Aruba demonstrates that the potential for short-term growth is greater in the corporate registry sector than in the three other offshore financial services sectors. This is because OBUs and offshore shipping and insurance companies are more likely to locate in well-established tax havens offering a sophisticated level of service to investors.

7.22 Should the GRB decide to proceed with an offshore financial services program, it is recommended that it commence solely with a corporate registry program. This focused approach has a number of advantages. It will be much easier for the government to regulate one offshore financial services program, especially given the limited manpower capabilities presently available. In addition, the lack of accountants and lawyers in Burundi make it virtually impossible to provide the necessary support services to foreign investors. By limiting the program to corporate registry, a better understanding of the needs of foreign investors in this sector can be achieved, and will increase the possibilities for local participation and employment. Finally, if the program is a success and Burundi becomes better known to potential investors, the program can potentially expand to include other financial sectors. To attract OBUs, for example, the best promotional tool is a strong and active corporate registry that can transfer substantial amounts of funds through the banks.

7.23 Nonetheless, it is necessary to recognize the limitations of this program. First, while the administrative burden of offshore corporate registry is minimal compared to other offshore services, there are costs to be incurred. These include the establishment of the legal framework for the program, as well as annual expenses associated with general monitoring of the program. Second, a corporate registry will generate no significant employment, with the exception of providing work for a few lawyers and accountants.

7.24 Finally, it is not clear what companies, nor how many, would register in Burundi. As with the other tax havens discussed above, there are other countries better suited geographically to serve European, Asian, North American, or Middle Eastern firms. If only 4 to 5 companies were to register, paying a nominal annual fee of US$250 to $300 per year, the cost of administering could easily exceed the gains in revenue to the government.

7.25 **Bearing these substantial limitations in mind, should the GRB decide to establish a program, it will be necessary to institute a highly competitive incentive package.** The regime should follow that of the BVI, which has become the prototype for such programs in recent years. The key incentives should include:

- the company need have only one shareholder, and the identity of shareholders and directors need not be disclosed;
- shares can be issued in bearer form, with or without par value and in different classes;
- no audited financial statements or annual returns are necessary;
- companies can be allowed to engage in any lawful activity except banking, insurance, and shipping; companies cannot conduct business or own real estate in Burundi;
- companies are registered and approved in one day with a minimum of formalities; and
- annual government fee per company should be approximately US$250-300.

7.26 Considering the difficult constraints faced by Burundi, the adoption of a phased approach in the establishment of an offshore financial services program will allow the GRB to move slowly and carefully in instituting a well-designed program. In this way, the law and administration of the corporate registry can be designed to be highly attractive and to function smoothly. In addition, this approach will allow the GRB to reduce start-up and administrative costs -- a necessary action given the modest levels of interest expected.

B. PROSPECTS FOR INDUSTRIAL FREE ZONE DEVELOPMENT

1. Economic and Market Assessment

7.27 A successful IFZ program is the result of internationally competitive economic factors of production, a well-designed legal and incentive framework, and a well-designed and efficiently implemented institutional and administrative structure. Not all these factors must be equally competitive -- and no IFZ country or program worldwide is flawless -- but to attract investors, the sum total of a program's assets must outweigh its weaknesses. For an IFZ program to be truly successful, however, not only must the positive elements outweigh the negative ones, but the total benefits must also outweigh the costs.

7.28 The preceding analysis in Chapters 5 and 6 identified a number of benefits and constraints in the Burundian enabling environment for free zone development. To assess whether an IFZ makes sense in the Burundian context, however, four additional factors need to be evaluated: what is the likely level of participation in a Burundian IFZ regime; are there sufficient institutional resources to manage such a program; do the probable benefits of the program outweigh the potential costs; and, finally, is such a regime even necessary in Burundi's current policy environment?

7.29 Drawing upon the analysis in Chapter 5, it appears probable that total demand for free zone facilities in Burundi will be very limited, relative to other potential or existing IFZ countries. This limited demand will be the result of a number of factors:

- The price of land transport is prohibitively expensive. Therefore, the only industries which could operate under an IFZ program and export successfully to Europe are those sectors for which it is financially feasible to utilize air freight. This limitation restricts sharply the variety and types of industries that could operate in Burundi, even barring other constraints.

- Levels of foreign investment in Burundi have been negligible in recent years. The growing investment opportunities in Eastern Europe and the limited buying power of the regional market, coupled with historic investment patterns, weigh against a sharp reversal in investment levels. It is unlikely that a Burundian IFZ has much significant potential to attract foreign investors, at least in the short- to medium-term. As a result, the leading users of a potential Burundian IFZ are likely to be local firms. The local private sector, however, is extremely small and produces few goods, with the exception of textiles, that have either a potential market outside of the region and which are suitable for air freight. Moreover, in general local firms have little to no experience in producing goods of sufficient quality, quantity, or timeliness for foreign markets, nor are they experienced in promoting or marketing their products overseas.

- Levels of regional trade provide an insufficient basis from which to develop an IFZ program. While there is some potential for expanded exports regionally, there are a number of reasons why expectations should be modest regarding the role of regional trade as the engine of Burundian economic growth. These include the low level of purchasing power and sluggish economic growth in neighboring countries, the similarity among regional industries, and the continuing existence of tariff and non-tariff barriers. These constraints limit the likelihood that in the near- to medium-term a substantial number of IFZ firms will be established to produce for the regional market.

- The level of demand evidenced does not justify the costs of establishing an IFZ.[4] The establishment of an industrial park-style IFZ is clearly not warranted. The cost of establishing a 10 ha. IFZ -- which is small by international standards -- would be in the range of US$8 million. Given the limited demand for such facilities, it is highly improbable that such a project could be economically viable in Burundi. Even if the IFZ program was limited to single factory free zones, however, under which individual firms could operate as single IFZs, start-up and operating costs would not be insubstantial. Single factory free zones are often more costly to regulate and administer than industrial park-style IFZs, because infrastructure, Customs, and other regulatory services must be provided on a geographically dispersed basis, rather than in one centralized location.

2. Institutional Assessment

7.30 Given that the transport costs and market position for a Burundian IFZ are largely unfavorable, the potential benefits to be gained from establishing such a program are limited in Burundi. Moreover, the instititutional and administrative cost of its establishment and implementation could potentially offset the incremental increase in foreign or domestic investment resulting from the creation of an IFZ regime. For example, if program participation is to be limited, it is not financially feasible to create a separate oversight authority. Such agencies are costly to establish and to operate, requiring the procurement of facilities and equipment, the hiring of staff, and other such costs commensurate with the creation of a new institution. As discussed in the previous Chapter, however, none of the existing institutions, such as APEE or the Chamber of Commerce, is an entirely suitable choice for locating an IFZ regulatory and oversight body.

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[4] It is not within the scope of this project to conduct a cost-benefit analysis of a potential Burundian IFZ, and a full market survey would be necessary to assess more fully probable market demand.

7.31 Placing the authority within the government creates other difficulties. Typically, it is preferable to remove the oversight body from direct ministerial control in order to reduce political interference in investment approvals, improve efficiency, and ensure that the oversight authority is responsive to private sector needs. Moreover, officials at the Ministry of Commerce -- the most logical location for such an agency within the GRB -- have conceded that the Ministry lacks the efficiency or the human or other resources to run the program effectively at this time.

7.32 Furthermore, there are substantial administrative costs associated with establishment and operation of an IFZ program, even if undertaken on a very limited scale. In addition to drafting a law and regulations, the necessary Customs and other regulatory procedures must be developed; personnel need to be hired or seconded from other agencies to administer the program; and the program must be promoted to foreign and local investors alike. The operating costs of the free zone authority in Togo, for example, are budgeted at approximately US$300,000 per year. In light of the program's small participation, it is entirely possible that these administrative costs could exceed the economic benefits accruing to Burundi.

3. Relationship to Current Government Macro-economic Policy

7.33 Most importantly, however, the substantial economic reforms adopted by the GRB under the structural adjustment program have already eliminated many of the policy reasons why governments typically establish IFZ programs. The economies of most IFZ countries are characterized by highly distortive economic policies, including high duties on imports, import and export taxes, excessive levels of taxation, and overvalued exchange rates. Faced with uncompetitive economic environments -- but unwilling to introduce wide-ranging economic reforms -- governments worldwide have used the IFZ concept as a way to introduce broad policies of economic liberalization on a limited, and politically palatable scale. In countries such as Cameroon, for example, the IFZ policy regime is substantially different from the policies governing the rest of the economy. IFZs are no substitute, however, for significant economic reform and extended economic liberalization.

7.34 To varying degrees, Burundi has already adopted these export-oriented measures on a nation-wide basis. The exchange rate is highly competitive, tariff levels are low, export taxes have been eliminated, and import licensing has been liberalized. By adopting these liberalizing policies, the GRB has created a largely hospitable environment for export growth in a very short amount of time. Moreover, the efficiency of Customs and the speed at which Customs procedures can be completed in Burundi strongly reinforces the export enabling environment created by these liberalized economic policies. By contrast, in countries where the IFZ program was used as the forefront of limited economic reform, it has taken a much longer period of time for similar measures to be introduced throughout the economy. In some successful IFZ countries, such as the Dominican Republic, such reforms still have not been extended throughout the economy, and as a result, the economic benefits associated with the IFZ program have not spread to other sectors of the economy.

7.35 Notwithstanding some of the inherent barriers to successful IFZ development in Burundi, it appears that the development of such a program is largely unnecessary. Given Burundi's small size and the substantial reform efforts that have been made, and in light of some of the insurmountable constraints faced by the country, it is inherently more pragmatic to continue to modify and improve the existing enabling environment for exporters. Likewise, from a cost perspective, it is more sensible to enhance existing mechanisms and strengthen implementing institutions than to create new ones.

7.36 This approach will allow scarce resources -- especially donor resources -- to be targeted more effectively. In particular, the weaknesses and inexperience of Burundian businesses in fundamental areas of business development and management need to be addressed if the Burundian private sector is to be able to grow substantially, to account for a greater share of national economic activity, and to play a significant role in export development. Utilization of the APEX program, for example, has been constrained by the fundamental inability of many applicants to prepare adequate investment proposals, illustrating that basic Burundian business skills are in need of substantial enhancement. Since local firms are likely to be the key source of any expanded export growth, it would be a mistake to invest resources in the creation of an IFZ program <u>before</u> ensuring that the most likely users of such a program would be able to take advantage of it.

C. RECOMMENDATIONS TO STIMULATE BURUNDIAN EXPORT EXPANSION

7.37 There are a number of areas where the GRB can implement improvements in the export enabling environment. These include improved access to export incentive schemes, enhancements of the incentives offered to exporters, and, most importantly, a number of procedural changes. The adoption of the measures outlined below will create an export regime comparable to that of an IFZ.

1. Improved Export Incentives

7.38 Table 7-1 compares the export incentives currently available under Burundi's 1988 Export Decree-Law to the incentives offered in a number of IFZ countries. While the incentives currently offered by the GRB are attractive, it is evident that there are areas where these incentives could be further improved for exporters of manufactured goods.

7.39 The Export Decree-Law grants a wide variety of fiscal benefits to exporters that are quite generous by international standards. The key incentive under the Law is the duty drawback program. This mechanism works extremely well in Burundi; unlike most countries where the long delays required to receive restitution render the duty drawback mechanism relatively useless as an incentive. To overcome this, IFZ countries typically grant complete exoneration of all import duties to exporting companies which export 80 to 100 percent of their total output. Since the drawback program works so effectively in Burundi, however, it is essentially equivalent to a complete exoneration. Moreover, the duty drawback mechanism is a highly appropriate export mechanism for a country where most firms are likely to export only a small proportion of their total output.

7.40 After a slow start-up, current utilization of the drawback program is still very low. The government should direct efforts to improving businesses' awareness of the drawback scheme, highlighting the efficiency with which it now operates, in contrast to the previous program.

7.41 Under the Law, exporting companies receive tax credits for transaction taxes and other indirect taxes paid on production inputs and packaging materials used in the production of goods for exports. As with the drawback system, this system can be an effective way to extend export incentives to firms that only export a small percentage of their total production. Within the scope of this study, it could not be determined if this procedure works effectively. The GRB should examine this system to ensure that it does work efficiently, and that companies are satisfied with its operation. If this not the case, however, the GRB should refund these taxes in a manner similar to the operation of the drawback program.

7.42 Other incentives which could be added to enhance Burundi's attractiveness to both foreign and local export investors include:

- **Implement income tax holidays on all earnings from exports.** Exporters currently pay one-half of the normal business tax rate on profits earned from exports, lowering the tax rate for exporters to 22.5 percent. To further encourage exports of manufactured goods, taxes on earnings from exports should be eliminated entirely for a period of at least 10 years; after 10 years a low, flat rate (of 10-20 percent) should be levied. For firms exporting more than a specified share of their production -- for example, 70 percent -- their should be a 100 percent tax exoneration of all income, regardless of its source. Similarly, all taxes on capital and dividends should be eliminated for exporting firms, also for a 10-year period. This 100 percent exemption, typical of most IFZ regimes, would improve the operating environment for exporters, but would not cause a substantial loss of government tax revenue given the small size of the manufacturing sector overall, and the current low levels of exports.

- **Link the level of tax exoneration directly to the level of exports.** Taxes are now assessed on the amount of profit earned from exports. This system is more difficult to administer because it relies on profits reporting. Moreover, the system can encourage fraud, as companies may try to illegitimately attribute some non-export related earnings to export earnings. Instead, the level of tax exoneration should be linked directly to the percentage of total production that is exported; that is, for a company that exports 20 percent of its total production, 20 percent of its profits are exempt. Such a system is much easier to administer because it is automatic and straightforward, and it also eases the bookkeeping burden on companies.

TABLE 7-1
COMPARISON OF EXPORT INCENTIVES IN SELECTED COUNTRIES

	Cameroon (IFZ)	Dominican Republic (IFZ)	Mauritius (IFZ)	Burundi (1988 Export Law)	Togo (IFZ)
Corporate Income Tax Abatement	100% exemption for the first 10 years; 15% tax thereafter	100% exemption for 15-20 years depending on location	15% tax rate	22.5% on income earned from exports	100% exemption for the first 10 years; 15% tax thereafter
Capital/Profits Repatriation	Unrestricted	80-100% exempt depending on location	Unrestricted	Restricted	Unrestricted
Duty Treatment for All Imports and Exports	100% exemption	100% exemption	100% exemption	Effective 100% exemption under duty drawback program	100% exemption
No. of Days To Receive Approval	30	30	20-40	40 days to 2 months; up to 5 months under the Investment Code	30
Tax on Dividends	100% exemption in perpetuity	80-100% exemption depending on EPZ location	100% exemption for 10 years	20% rate of tax	100% exemption in perpetuity
Sales To Local Market	Variable; decided on a case-by-case basis	20% of total output	10% of total output	Unrestricted	20% of total output
Management of Foreign Currency	Unrestricted	Unrestricted	Unrestricted	Restricted	Unrestricted

Source: Compiled by TSG.

- **Allow exporters to automatically benefit from all tax exonerations granted under other export regimes.** Investors qualifying as priority firms under the Investment Code, are exempt from taxes such as land taxes and the "impôt mobilier." Exporters should be similarly exempt from all such land taxes, stamp taxes, transactions taxes, service taxes, and any other taxes. Such exoneration should be granted in perpetuity. All such taxes should specifically be identified and the exonerations should be granted automatically in proportion to the percentage of total output which is exported. For companies exporting 70 percent or more of their total production, the level of exoneration should be 100 percent. This measure is comparable to exemptions offered in IFZs.

- **Grant incentives equally to both foreign and domestic, and large and small, firms.** All companies should be equally eligible to receive export incentives. In addition, there should be no minimum investment requirements to receive benefits, as there are now under the Investment Law. Small firms can also contribute to an expansion in exports; in Taiwan, small, family-owned companies played a predominate role in the early stages of the country's export expansion.

7.43 An export incentive regime containing these changes would not differ substantially from the incentives now potentially available to priority industries under the 1987 Investment Code or to firms under the 1988 Export Law. There are a number of additional improvements, however, that are needed in the regulatory regime governing exporters in Burundi. These are:

- **Grant incentives automatically and uniformly to qualifying firms.** The Investment Code is a poorly designed document setting forth four different investment regimes. While three of the regimes offer various types of incentives to investors, these are granted on a case-by-case basis. Not only is this lack of clarity and automaticity confusing to investors, but it also creates the potential for corruption. The qualities of transparency and automaticity are the two key characteristics of an IFZ regime. By granting incentives on an automatic and uniform basis to all qualifying exporters, the GRB will achieve what IFZs achieve only on a limited, narrow basis.

- **Clarify the relationship between the Investment Code and the Export Decree-Law, and make clear to potential investors which regime applies.** As it now stands, the relationship between the two regimes is extremely complicated and unclear, especially to potential foreign investors. Finally, the incentives available to exporters should be clearly spelled out in an easily obtainable, concise brochure. Creation of such a brochure is particularly important given that the 1988 Export Law has been amended several times, thus making it more complicated for investors to understand.

7.44 It should be noted that some potential revenue loss could be incurred by the GRB as a result of granting incentives to exporters to the regional market. Companies benefitting from substantial tax and other incentives can presumably afford to sell their goods at lower prices in neighboring countries than in Burundi. The potential loss would result from goods being smuggled back into Burundi and re-sold on the informal market, thereby depriving the government not only of the potential tax revenue of the goods production (since the firm would pay taxes on goods produced for the local market), but also from also from the transactions tax. Such sales would also undercut these companies' sales in the domestic market. Similarly, there would also be considerable incentive to smuggle back into Burundi products sold in neighboring markets at unrealistic, government-fixed prices. In both cases, it is expected that these losses would be marginal, and that the benefits of augmented foreign exchange earnings accruing to the government should exceed this revenue loss.

2. Institutional and Administrative Reforms

7.45 The most important reforms that the GRB should make, however, relate to export procedures rather than to the incentives themselves. It is by no means necessary to have an IFZ program in order to implement the institutional and administrative efficiency that characterizes successful IFZ regimes. The key characteristic of the institutional and administrative frameworks in successful IFZs worldwide is the simplification of investment and other procedural requirements. The GRB can integrate these elements into current export and investment approvement procedures by introducing the following reforms.

7.46 **Reform the investment approval process.** The current investment approval process is slow, cumbersome, and confusing, especially to foreign investors who do not wish to dedicate the large amount of time, energy, or resources required to follow it through to its conclusion. As can be seen in Table 7-1 above, the time needed to receive investment approval under the Investment Code compares extremely unfavorably to IFZs countries. The following changes should be implemented:

- **Simplify documentary requirements.** For investors seeking benefits under the Investment Code, extensive documentation is required. Much of this information is unnecessary and should be eliminated. The information need only be sufficient to demonstrate that the project has export potential, adequate financing, and does not involve criminal activity. Evaluations of applications need only ensure that the information provided is not fraudulent, and that the investor is credible; there is no need for a financial analysis of the project because the burden and cost of failure rests with the investor.

- **Introduce a default approval mechanism.** The GRB should introduce a maximum permissible time period for approving applications; any investment application not approved within that stated period -- for example, 30 days -- would receive automatic approval and eligibility for incentives. Because the Commission Nationale des Investissments (CNI) and the

Conseil des Ministres represent virtually all sectors of government, there is no reason why approvals cannot be expedited, particularly if documentary requirements are simplified.

- **Eliminate the unnecessary duplication in the CNI and the Conseil des Ministres review process.** It is not necessary for both groups to review investment applications; again, this is particularly true if the documentary requirements are vastly simplified. Ideally, one agency should be put in charge of the approval process. A second option would be for the CNI to be empowered to independently approve applications below a certain total investment level. At the very minimum, both agencies should complete their review within the recommended 30-day default period.

- **Standardize the incentives available to investors.** The incentives granted should be the same for all investors, and should be granted automatically. In this way, potential investors know in advance what incentives are available. This automaticity and clarity also reduces opportunities for corruption. Similarly, foreign and domestic investors alike should be eligible for the same incentives.

7.47 It would be wrong to conclude that it is necessary to establish a new "one-stop-shop" to implement these changes. The speed with which investment applications are approved is simply the result of political will and commitment to encourage the growth of the private sector. The one-stop shop label means nothing without the procedural efficiency to support it.

7.48 **Reduce the time needed to receive classification as a "compagnie exportatrice."** While it appears that there have been improvements in this area, there are still cases where up to 2 months has been required to receive this classification. It is better to ease procedures affecting exporters, and then to withdraw their incentives or impose penalties should they fail to export, than it is to excessively delay the start-up of potential export companies.

7.49 **Ease foreign exchange regulatory procedures.** The amount of time needed to receive import licenses has been substantially expedited but all exporters, including Burundian nationals, should be allowed to have foreign exchange accounts, thus completely eliminating the need for import and export licensing. The ability to keep foreign exchange accounts is particularly important to foreign investors. The BRB currently guarantees firms receiving export incentives under the April 1988 law the needed foreign exchange to import inputs, and firms reported that they have no problems in obtaining foreign exchange. It could not be determined, however, whether the ease of obtaining foreign exchange was due to the BRB guarantee of access, or simply because there are adequate foreign exchange reserves in the country at the present time.

7.50 While reserves may be sufficient now, any future shortage would severely constrain the export sector. Moreover, enabling exporters to have foreign exchange accounts would ease the administrative burdens on exporting firms who must necessarily import a wide variety of inputs that are either unavailable in Burundi, or are of insufficient quality to be used for export production. A number of foreign companies already have this privilege, and extending it to all exporters should not represent a substantial problem. Regional trade in locally produced goods is conducted in local currency, and therefore there is no need to receive an import license. In addition, given the currently low level of manufactured exports currently going to Europe, the use of foreign exchange accounts is not likely to cause a substantial drain on the GRB's foreign exchange reserves in the near-term; in any case, as export levels grow, foreign exchange earnings grow, and much of this returns to the country as firms exchange it for local currency to cover local costs such as wages, rent, etc.

7.51 The benefits of these procedural improvements, as well as the incentives listed above, should apply equally to exporters to the regional market or to Europe, with the exception of foreign exchange accounts which are not necessary for exporters to the region. Not only does the region provide the most immediate export market -- albeit a limited one -- but under the CEPGL and PTA monetary accords, exports to neighboring countries also earn much needed foreign exchange, which can help to offset Burundi's recurrent current account deficit with its neighbors.

3. Summary

7.52 Burundi's policy environment for export-oriented firms has many positive characteristics. The economic reforms that have been implemented by the GRB have created a nation-wide economic environment which is more supportive of export expansion than those found in a number of IFZ countries. Continued liberalization of the economy, including privatization of state-owned enterprises and the implementation of banking sector and other regulatory reforms, will continue to improve the operating environment for exporters on a broader basis .

7.53 The recommendations outlined above constitute a straightforward package of measures that can directly improve the current export regime. Adoption of this approach has two advantages. First, it is the most cost-effective in light of the limited likely potential of a Burundian IFZ in the near-term. Second, it utilizes existing administrative mechanisms and laws, thereby avoiding the need to develop new procedures, laws, or additional administrative organizations. As a result, this approach can be implemented much faster than can the establishment of an IFZ regime.

ANNEX A

INTERVIEWS CONDUCTED

A. GOVERNMENT OF BURUNDI AND PUBLIC SECTOR OFFICIALS

Ministry of Commerce and Industry

Mr. Bonaventure Kidwingira, Minister of Commerce and Industry
Mr. Prosper Nindorera, Director General of External Commerce
Ms. Valerie Siniremera, Director of Studies and Industrial Documentation

Ministry of Finance

Mr. Pierre Binoba, Minister of Finance
Mr. Jean-Berchmans Nsabiyumva, Technical Advisor
Mr. Salvator Barayandema, Assistant Director of Customs Control

Banque de la République du Burundi

Mr. Isaac Budabuda, Governor
Mr. Araclet, Head of Export Service

Ministry of Labor

Deputy Minister

B. PARASTATAL COMPANIES

Cotebu

Mr. Jean Kabura, Director General
Mr. Anicet Ndayisaba, Commercial Manager

Verrundi

Mr. Lazare Nzorubara, Director General

Regideso

Mr. Bernard Barandereka, Director General

Onatel

Mr. Bernard Busoka, Director General

Otrabu - Office of Transport of Burundi

Mr. Hyacinthe Hajayandi, Director General

Siruco

Mr. Ndaye Ladislas, Director General
Mr. Jacques Persoons, Advisor

C. PRIVATE SECTOR REPRESENTATIVES

Meridian Bank Burundi

Mr. Mathias Ndikumana, Head of Commercial Services

Intercontact

Mr. Bonaventure Nicimpaye, Administrator-Director

SOGES

Mr. Nkurunziza Déogratias, Director

Interfreight Burundi

Mr. Georges Dubin, Director

Amiburundi

Mr. Emmanuel Nkundwa, Director

Cogetraff S.P.R.L.

Mr. Kana Jean, Director of Import-Export and Transportation Services
Dr. Jean-Bosco Sindayigaya, Lawyer

Sabena

Mr. Matsiko, Commercial Manager
Ms. Marée, Commercial Manager

Burundi Battery Inc.

Mr. Mpagaze Jerome, Commercial Director

La Commerciale

Mr. Maurice Nimubona, Commercial Manager

Erco

Mr. Jean Sindayigaya, Director General

Toyota Burundi

Mr. J. R. Trivedi, General Manager

E.P.B. & Arnolac

Mr. Bonaventure Ntahiraja, Civil Mechanical Engineer

Societe Nationale Des Peaux

Mr. Rurihose Salvator, Director General

N.A.B.

Director General

Eternit

Mr. Michel Rousseau, Director General

Buminco

Mr. Damien Riragonya, Adjunct Director General

D. **OTHER ORGANIZATIONS**

U.S. Agency for International Development

Mr. Donald Miller, Mission Director
Mr. Donald Hart, Private Enterprise Officer
Mr. David Leon, Project Officer

Chamber of Commerce of Industry, Agriculture and Handicraft of Burundi

Mr. Prime Nyamoya, Secretary General
Mr. Venant Ntabona, Statistician

Agence de Promotion des Echanges Exterieurs (APEE)

Dr. Astére Nzisabira, Director

Panesco

Mr. Patrice de Jaegher, Administrator

World Bank

Mr. Apoellinaire Ndorukwigira, Economist

Eastern and Southern African Trade and Development Bank

Mr. Victor Ciza, Director of Administration

Université René Descartes

Mr. Claude L. Cournot, Director of Education