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CAPE VERDE FREE ZONE PRE-FEASIBILTY STUDY

FINAL REPORT

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ACRONYMS AND ABBREVIATIONS

ACP	African-Caribbean-Pacific
ANP	Assembleia Nacional Popular
BCV	Banco de Cabo Verde
BRPE	Boletim de Registo Previo de Exportacao
BRPI	Boletim de Registo Previo de Importacao
CAAP	Comissao de Abastecimento de Agua à Cidade da Praia
CAD	Computer Aided Design
CBI	Caribbean Basin Institute
CENTROTEL	Central de Abastecimento Hoteleiro
CERIS	Sociedade Caboverdiana de Cerveja e Refrigerantes
CFA	African Financial Community
CFZ	Commercial Free Zone
CZF	Corporación de la Zona Franca
DGI	Direcao-Geral de Industria
EC	European Community
ECOWAS	Economic Community of West African States
ECV	Cape Verdean Escudos
EDS	Export Development Services
EMPA	Empresa Publica de Abastecimento
ENACOL	Empresa Nacional de Combustiveis
ENAPOR	Empresa Nacional de Administraço dos Portos
EPZ	Export Processing Zone
GOCV	Government of Cape Verde
GSP	Generalized System of Preferences
HTS	Harmonized Tariff Schedule
ICSID	International Center for the Settlement of Investment Disputes
IFC	International Finance Corporation
IFZ	Industrial Free Zone
IPI	Instituto de Promocao Industrial
IRR	Internal Rate of Return
LDC	Lesser Developed Country
METC	Ministry of Economy, Transport and Communications
NIC	Newly Industrialized Country
PROMEX	Centro de Promocao do Investimento e das Exportacoes
SFFZ	Single-factory Free Zone
SOCAL	Sociedade Industrial de Calçcado
TACV	Cabo Verde Airlines
TAP	Air Portugal
TSG	The Services Group
UPI	Unidade de Promocao Industrial; old name for IPI
USAID	United States Agency for International Development

US$1.00 = CVE73

EXECUTIVE SUMMARY

Introduction. The purpose of this report is to provide the Government of Cape Verde (GOCV) with an assessment of the Cape Verdean enabling environment for the establishment of an Industrial Free Zone (IFZ) and Commercial Free Zone (CFZ) 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.

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 -- already existing in Cape Verde -- is 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 320 industrial park-style IFZs are now operational and IFZ programs now account for an estimated US$29.5 billion in annual exports and employ approximately 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$640 million in exports. As a result, the unemployment rate has dropped from 23 to 3 percent in 8 years. Following the Mauritian success, a number of other African nations -- including Togo, Cameroon, Kenya, and Madagascar -- 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 Cape Verdean Environment for Free Zone Development. In terms of basic factors of production, Cape Verde holds few strong comparative advantages for investors. With the exception of the cost of land, there is no economic factor where Cape Verde has a clear comparative advantage. The country is relatively expensive in terms of water, electricity, construction, and transportation costs. The quality and reliability of infrastructure and transportation service also puts Cape Verde in a somewhat disadvantageous position. However, with pending improvements in these areas it is expected an adequate level of services for free zone activities will be possible.

The prevailing wage rate, though competitive, does not put Cape Verde in a leading position on this critical aspect. At a prevailing wage rate of US$0.69/hour, Cape Verde's wage rate is more than double those in Indonesia or Kenya and in the same range as those found in Mauritius, Haiti, and the Dominican Republic. This factor is critical, as labor costs can comprise up to 80 percent of operating expenses in typical IFZ firms.

Industrial Estate Site Evaluations. One of the major obstacles facing any potential investor in Cape Verde is the absence of suitable industrial facilities. At present, a new investor would have to go through the difficult process of selecting and requesting a location from the municipality, constructing or contracting out the construction of the facility, obtaining utility hook-ups, and then providing on-going security and maintenance for the facility. Because of the difficulties of this process for foreign investors, the existence of a fully-serviced industrial estate has been an attractive option to investors in many countries and construction of such an industrial estate with fully serviced standard factory buildings for rent is the most effective means of overcoming this constraint in Cape Verde.

With recognition of this need, potential industrial estate sites were examined in Mindelo, Praia, and Sal. Despite the fact that Sal has the best air transport and tourist facilities, it ranks at the bottom of the three choices due to its higher costs and scarcity of labor. Praia's advantages include the largest labor supply, better water service than Mindelo's, and the construction of the new airport. Furthermore, the Achada Grande site is the best of those presently being considered in Cape Verde, and already has financing committed from the EC. Constraints for Praia include a lack of available phone lines, and comparatively less productive labor and more onerous bureaucracy than elsewhere in the country.

Mindelo is hampered by the worst airport of the three and relatively less reliable water and electricity service. Moreover, the industrial sites presently being studied all have some defect. On the other hand, Mindelo has the best natural port, the strongest private sector, and the most productive labor force. It has also reportedly been the first choice of potential foreign investors visiting the country.

Assessment of the Cape Verdean Legislative, Institutional, and Regulatory Environment. The present legislative package is competitive with other IFZ countries and provides a firm legal foundation for export promotion. The duty-free importation and exportation of goods, materials, and equipment as well as the ten-year exemption on income and complementary taxes are competitive with other existing and emerging IFZ programs. Moreover, the ability to hold foreign exchange accounts, register via a 30-day default mechanism, and establish anywhere within the country are critical elements included in the existing legal framework. As such, Cape Verde already has in place a legislative package equivalent to an IFZ regime.

Administratively, importers have noted a significant improvement in Customs operations over the past few weeks, a key aspect in any export-oriented program. Moreover, the existence of PROMEX gives Cape Verde a new tool in promoting the country.

Commercial Free Zone Development. There are basically two CFZ categories. The first concentrates on high value, high duty products such as jewelry, electronics, watches, and medical products. This form of CFZ typically combines aspects of wholesale duty-free shopping and exhibition centers. The second form of CFZ revolves around bulk and break-bulk transshipment and as such should be seen as an extension of port activities; products normally handled include grains, cement, steel, and lumber.

CFZs of the high value variety rely greatly on air transport for both passengers and merchandise delivery. At the present time, Cape Verde's transport and telecommunications links -- particularly to Africa -- seriously limit the potential for this type of project. The potential appears to be better for high volume CFZ activities. Cape Verde's main advantage is that the port of Mindelo is well-run by regional standards -- the critical factor for high volume CFZ activity. Whether the actual market for this activity is sufficient for the capital investment required is presently being studied under an IFC project.

Conclusions and Recommendations. Cape Verde, at least in the short- to medium-term, can expect only modest success with an IFZ program. Weighing the comparative advantages and disadvantages, an IFZ program could attract 5-15 firms over the next 3-5 years. Using an average of 100 workers per factory, employment of 500-1500 jobs could be generated, leading to foreign exchange earnings of roghly US$1-3 million and an increase in exports by roughly US$2.5-7.5 million.

A Cape Verdean IFZ program would necessarily be oriented towards Europe for both investors and export markets. The combination of the best transport connections, preferential market access, absolute size and buying power of the market, and investor interest, make Europe the most likely export market. To the extent that surface and air transport improve, the United States could become the secondary market. Prospects for regional trade are limited. While the regional population is large, the buying power is relatively small and West African economies have been characterized by extreme instability. Transportation and telecommunications links to the continent remain poor.

Given the fact that Cape Verde has only modest potential for IFZ development, the recommendations have been designed to reflect a least cost approach for the GOCV. Consequently, it is recommended that no new bureaucracy be created, the existing legislative package be revised rather than revamped, and the private sector be utilized to the fullest degree possible in industrial estate development.

In terms of factors of production, the key recommendations are:

- the GOCV should not establish a minimum wage rate;
- allow open competition in telecommunications;
- improve air freight and passenger service.

Cape Verde is in the fortunate position of financing committed for an industrial zone (though not a fully-serviced industrial estate) at Achada Grande. However, it is evident that no adequate market analysis has been conducted to determine whether the Achada Grande site is viable, or whether an alternative project in Mindelo would have more potential. As such, it is recommended that:

- a feasibility study be conducted for an industrial estate project in Cape Verde, based on the findings of a comprehensive market analysis;
- the GOCV should then evaluate the costs and benefits of an industrial estate versus other opportunities available.

If the market analysis is positive, and one, or two, industrial estates
prove to be both financially and economically viable, the GOCV can then proceed through the following steps:

- establish a general purpose industrial estate for exporting, import-substitution, and commercial warehouse firms,
- rely on the private sector, rather than the GOCV to develop and manage the industrial estate.

Because the legal and regulatory foundation for an IFZ-like program already exists, future short-term policy action is reduced. Nonetheless, the following items would be beneficial:

- modify, rather than revamp, the existing legislative package;
- finalize the remaining implementing regulations.

Adoption of this least-cost approach has two advantages. First, it is the most cost-effective strategy given the modest potential in the near-term. Second, by utilizing existing laws and private sector participation, a competitive program can be implemented much faster.

Although tourism, fisheries, and offshore financial services offer other alternatives to generate foreign exchange earnings and employment opportunities in Cape Verde, the IFZ concept provides it with its only real option to industrialize. While Cape Verde may be able to attract a handful of other import-substitution firms, the small internal market will prevent the creation of any substantial amount of activity even in this sector. In contrast, IFZ programs have demonstrated the ability (given competitive factors, proper design and implementation) to enable small, remote island nations such as Mauritius and Fiji to enter the global industrial marketplace. As such, even with the existing constraints, Cape Verde should proceed with this approach.

I. INTRODUCTION

1.01 The purpose of this report is to provide the Government of Cape Verde (GOCV) with an assessment of the Cape Verdean enabling environment for the establishment of an Industrial Free Zone (IFZ) and Commercial Free Zone (CFZ) regime in Cape Verde. This study has been executed by The Services Group (TSG), under a contract with the U.S. Agency for International Development (USAID), via the mechanism of the Private Enterprise Development Support Project.

1.02 The focus of this study is a preliminary evaluation of Cape Verde'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 GOCV's economic development goals. This report was prepared based on data gathered by a field mission in Cape Verde comprised of Robert Rauth and Mark Connell from May 27 to June 16. Subsequent documentary analysis in TSG's home office in Washington, DC, was conducted with James Emery.

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 industrial and commercial free zones, 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 Cape Verde are analyzed. This includes an evaluation of the quality and quantity of Cape Verde'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 and trade patterns.

- Chapter 6 evaluates prospective industrial estate sites and presents potential sources of finance and technical assistance for any future zone development.

- The current institutional and regulatory environment in Cape Verde is the subject of Chapter 7, which reviews export policy and incentives, Customs and other procedures affecting export-oriented businesses, and examines key Cape Verdean institutions overseeing the export sector.

- Chapter 8 provides an overview of prospective CFZ projects in Cape Verde, examining the assumptions and conditions required for their success.

- The study's conclusions and recommendations are made in Chapter 9, where the viability of industrial free zone development for Cape Verde is examined. The Chapter concludes with recommendations to increase industrial export activity in Cape Verde.

1.04 The study team particularly benefitted from the guidance and assistance of José Gonçalves, EDS Project Administrator, USAID/Cape Verde, and local consultant, Adao da Silva Rocha. The views expressed in this report, however, are those of the TSG/EY project team, and do not necessarily reflect those of the Government of Cape Verde 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.

2.02 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. This type of free zone has already been established in Cape Verde; to date, four banks, 43 corporations, and two insurance companies have registered in Cape Verde. Like IFZ firms these operations are considered extraterritorial and offshore financial entities are generally prohibited from conducting business in the local economy.

B. COMMERCIAL FREE ZONES

1. Overview

2.03 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.

2.04 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.

2.05 Within the region, the Canary Islands has the only port making a strong effort at becoming a transshipment center. The port of Las Palmas in 1989 had nearly 17,000 ship visits

with a total gross tonnage of 50 million tons. Total tons of merchandise was approximately 10 million tons, of which, 852,347 were bulk dry goods. Transshipped merchandise equalled only 4,809 tons.

2.06 The ports of the Canary Islands are under the direct control of Spain's Ministry of Public Works. Port policy and handling charges are determined by Madrid. Las Palmas is a free port, but port charges are equal to those in Spain. Fishing fleets from Japan, South Korea and the Soviet Union use the Canaries as their main international bases.

2.07 The port reportedly provides much higher level of services than typically available in West Africa. Las Palmas has nine principal docking areas, including fishing, commercial traffic, a naval base and repair docks, stretching for 11,000 meters. The dock is capable of receiving the world's largest ships. Considerable warehouse and storage space is available: 215,000 sq.m. open air and 15,000 m3 of refrigerated space, 28,000 sq.m. of covered space with 5,000 sq.m. of semi-covered space. All of these facilities are to be expanded by 20 percent over the next five years. Other services offered by Las Palmas include rapid refueling (between 30-1,500 tons/hour from more than 350 supply points) and rapid resupply of fresh drinking water (the port's desalinization plant can pump 500 tons/hour). An on-site ice plant produces 200/tons/day. The port's duty-free status ensures cheap fuel and geographically the port is well situated between Africa, Europe, and the Americas.

2.08 While the port remains profitable, traffic grew by just one percent in 1989 and the large port staff -- with 2,500 employees -- is making it difficult to keep costs competitive. In the early 1980s, Las Palmas efforts to become an important transshipment center failed due to its high costs.

2.09 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.

2.10 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.

2.11 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, there are two broad divisions. The first is high volume, bulk and break-bulk transshipment, which handle grains, cement, steel, lumber etc., and can be found in the port of Kingston, Jamaica or Lomé, Togo. The second division concentrates on high value or luxury goods such as jewelry, electronics, appliances, watches, clothing and medical products predominate. Examples of this division can be found in the free zones of Miami and Curacao. Both types of CFZs are often used by companies as a central supply source serving multiple destinations.

2.12 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

2.13 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

2.14 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

2.15 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.

2.16 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.

2.17 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.

2.18 Ireland's success was quickly emulated by a number of Asian countries. Taiwan was the first country to successfully replicate Ireland's IFZ concept with the establishment of the Kaohsiung IFZ in 1966. Within three years, this zone was completely filled and by 1972 was host to 57,000 workers. Two other zones were constructed in 1971 to meet the increasing demand for space in Taiwan. Currently, the Taiwanese IFZs are responsible for more than 70,000 jobs and US$3.7 billion in annual exports.

2.19 During this same period, IFZ-style programs were established in a number of other countries around the world, including South Korea, Malaysia, Mauritius and the Dominican Republic. As in Taiwan, IFZ exports and experience gave impetus to broad economic liberalization policies in South Korea and Malaysia. Malaysian zones, for example, presently employ approximately 100,000 workers and annually generate US$1.7 billion in exports.

2.20 EPZs have also proven successful in the Western Hemisphere, especially in the case of the Dominican Republic. The growth of EPZ exports between 1975 and 1987 averaged nearly 24 percent annually. In 1989 alone, the value of EPZ exports rose by 37 percent to US$686 million while employment jumped by 47 percent to 124,000 workers. Significantly, this growth occurred while all other national exports evidenced an average negative rate of growth of one percent per year for the same 12-year period. Other successful EPZ sponsors in the Western Hemisphere include Costa Rica and Jamaica. Over the past decade, more than two thirds of all net new manufacturing and assembly jobs created in the Caribbean Basin -- more than 225,000 -- have been located in EPZs.

2.21 Within the African region, the Mauritian IFZ program has been the most notable success. Mauritius, heavily dependent on a volatile monocrop industry (sugar) and lacking in resources other than its one million people, established its IFZ program in 1971. Although the program was moderately successful in the 1970s, structural improvements in the Mauritian economy created an ideal environment for IFZ industries. The 1982 unemployment rate of 23 percent has been virtually eliminated and labor shortages began to emerge as early as 1988. Today there are 570 IFZ firms employing 89,000 workers and generating US$642 million in annual exports. Because of increasing labor rates, low value-added industries are beginning to establish operations in other offshore manufacturing centers while existing IFZ firms are undertaking higher value-added processing. In this manner, Mauritius is rising on the economic development ladder.

2.22 The experience of African IFZs in countries other than Mauritius has been disheartening. While relatively few countries had established IFZ programs prior to 1989, political uncertainties and civil unrest in large parts of the continent have contributed to negative investor perceptions. Other fundamental shortcomings in African IFZ development include the following:

1) Complicated and uncertain investment and operating climates for private firms. Although zone incentive regimes offered by countries such as Liberia are relatively positive on paper, in practice the operating and investment approval procedures are

complex and time-consuming. Other zones have been hampered by poorly designed laws. Senegal's IFZ was hurt by a provision requiring a minimum number of workers and investment. Senegal has also been constrained by the fact that the zone management regulatory body, though theoretically autonomous, has little power and its jurisdiction is unclear.

2) Bureaucratic development/management organizations. No privately-owned or operated zones existed in sub-Saharan Africa prior to 1991. Zone management in African IFZs has been notoriously unresponsive. Zone facilities and infrastructure have been allowed to deteriorate badly in Liberia; in Senegal, zone management refuses to construct standard factory buildings for tenants, forcing firms to undertake construction themselves -- a difficult task for foreign investors in an unknown country. This unresponsiveness in Senegal exists despite the fact that the zone administration has 50 employees for a program that has generated only 600 jobs.

3) Poor locations. In Zaire, the Zone Franche d'Inga was located in a remote section of the country with poor communications and transport linkages. The location was also poorly chosen in that it offered few workers with adequate skill levels. Using IFZs as a growth pole strategy, despite the attractiveness of the idea, has failed in most instances.

4) Serious deficiencies in international telecommunications and power supply. Despite the growing importance of voice, data and telefax links in world markets, African countries sponsoring IFZs to date have taken few steps to remedy problems of high prices, long connection delays for new service, and limited capacity. The poor power distribution in the Dakar area has proved to be a major constraint with the Senegalese program.

5) Unreliable and costly transportation services. For the most part, African nations are poorly served by international air and ocean freight. In addition, African ports, in general, are expensive, slow, and subject to high levels of pilferage and damage.

6) Overvalued currencies. In the late 1970s, the Mauritius IFZ program began to stagnate due to an unrealistic exchange rate. However, between 1979 and 1981, the Government of Mauritius devalued the rupee by 50 percent, allowing zone firms to once again become cost competitive on the world market.

7) Labor difficulties. In Senegal, wage costs are uncompetitive, labor is considered unproductive relative to that of other zone-sponsoring countries, labor-management relations have been troubled, and rigid labor code provisions make it difficult for employers to discharge employees who fail to perform.

2.23 All of the above factors have held back IFZ development in Africa. However, as in Mauritius, similar shortcomings were once responsible for slow initial results from IFZs in

Jamaica, Sri Lanka, and the Dominican Republic. These countries removed initial legislative and/or regulatory obstacles, and subsequently saw rapid growth in IFZ employment and foreign exchange earnings. It is therefore possible that future changes may be made in the Senegalese, Zairian, and Liberian IFZ programs to improve their performance.

2.24 Owing to the failure of import-substitution oriented and centrally planned economies, many African countries are attempting to duplicate the success of Mauritius and other IFZ-host countries. In the past three years, four African countries -- Togo, Cameroon, Madagascar, and Kenya -- have made rapid progress in implementing IFZ programs that avoid many previous mistakes. Similarly, the question of whether IFZ programs should be established is being studied in Burundi, Ethiopia, Zimbabwe, Ghana, Malawi, Mozambique, and Namibia.

2.25 To date, Togo has approved over 30 projects from 11 countries in a wide variety of sectors. It is estimated that after three years these companies will employ 4,000 workers and will have invested approximately US$60 million. In contrast to typical IFZ programs, clothing, footwear, and electronics firms account for only two of the firms. Steel, agro- and seafood-processing enterprises are the most common sectors. This atypical sector representation reflects the regional focus of these companies. Although all of the firms have established as SFFZ, two privately industrial estates are being planned/constructed.

2.26 Madagascar, which has so far followed a SFFZ approach, has approved 16 firms, all but one of which are in the knitwear/apparel sectors. The sector orientation of these firms reflects the dominance of Mauritian investors. It is estimated that these firms will create 6,000 jobs. At present, there is one industrial estate in the planning stages. In Kenya, a private IFZ industrial estate has been constructed and has one tenant; two public sector zones are in the planning stage.

2.27 Though not considered a part of Africa, Madeira must also be considered a potential competitor with Cape Verde. The establishment of Madeira as an offshore business center for manufacturing and financial enterprises has been slower and more difficult than originally expected. A 120 ha. industrial estate/IFZ is planned on Madeira's eastern coast 8 km from the airport and 30 km from Funchal, the island's main town. About one half of the 40 ha. first phase has been levelled with telecommunications and water supplies installed. Work on a new deep sea port serving the site began in 1990 and is due to be completed in mid-1992. The island's main airport is also being expanded to receive larger aircraft and improve freight facilities.

2.28 Incentives include a full tax holiday through the year 2011 -- or twice as long as is available in Cape Verde. Establishment procedures have been well implemented and it is possible to incorporate a company in just two weeks. However, the Portuguese Central Bank is arguing that Portuguese subsidiaries be treated under the same tax regime as their parent companies. If this were to occur, it would provide a niche for Cape Verde in attracting Portuguese investors.

2.29 Ten companies have been approved under the IFZ regime and include investments from Brazil, Ireland, Lebanon, Liechtenstein, Hong Kong, and Portugal. The range of industrial activities is also diverse and includes sectors such as plastics, jewelry, precision optical instruments, garments and textiles, construction materials, tobacco, electronics, food, and chemicals. Only a handful of these enterprises have begun operation, most are constructing facilities or installing machinery. In addition, administrators of the program note that there has been a great deal of inquiries coming in.

2.30 The Azores archipelago, another autonomous Portuguese island group, should also be considered as a potential competitor for Cape Verde. In the mid-1980s, following the precedent set in Shannon, Ireland, the regional government considered a free trade zone as a means to revitalize its relatively obsolete airport and catalyze economic growth. As a result, in February 1982 the Santa Maria EPZ was officially created and established in a fifty-acre area adjacent to the airport on the western side of the island.

2.31 Currently, more than 40 countries worldwide have established IFZ programs (see Tables 2-1 to 2-3). Over 320 industrial park-style IFZs are now operational and accounting for an estimated US$28.5 billion in annual exports and employing approximately 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.

2.32 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. According to an internal World Bank study, of those with a sufficient basis to judge, approximately 60 percent of IFZ industrial estates are predominately or partly successful (including zones in Taiwan, Malaysia, South Korea, the Dominican Republic, Costa Rica, Indonesia, and Sri Lanka). Approximately one-third of all zones can be judged as unsuccessful, with export and employment benefits below the costs of achieving them (examples include zones in Colombia, Liberia, Senegal, and India).

a. Single-Factory Free Zones (Enterprise Franche)

2.33 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.

2.34 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.

2.35 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. The availability of ready-to-occupy factory space has proven to be an effective promotional tool in a number of countries.

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

TABLE 2-1
ASIA EPZ AND EPZ-STYLE PROGRAMS (/1)

Country	Number of Operating Enterprises	Number of Operating Zones				Number of Zones Designated, Planned, or Under Construction	Number of Future Private Zones	Direct Employment	Annual Exports (US$ millions)
		Private	Public	Mixed	Total				
Bangladesh	70	0	1	0	1	3	0	7,000	14
China	2,500	0	22	0	22	0	0	2,000,000	3,900
Fiji	71	0	0	0	0	1	0	7,000	35
India	201	0	6	0	6	1	0	50,000	300
Indonesia (/2)	120	0	2	0	2	12	8	50,000	146
Malaysia	280	0	12	0	12	1	0	98,900	1,679
Pakistan	33	0	1	0	1	1	0	2,000	115
Philippines	100	1	3	0	4	6	n/a	35,000	414
South Korea	98	0	2	0	2	0	0	36,000	1,800
Sri Lanka	134	0	2	0	2	1	0	55,000	140
Taiwan (/3)	251	0	4	0	4	0	0	70,700	3,700
Thailand	27	0	5	1	6	11	0	28,000	140
Totals	3,885	1	60	1	62	37	8	2,439,600	12,413

Note: n/a = Not available
(/1) The freeports of Hong Kong and Singapore have not been included.
(/2) The island of Batam is a freeport on which there are a number of industrial estates being constructed.
(/3) The number of operating enterprises, direct employment, and annual exports of the Hsin-Chu Science Park are not included.

TABLE 2-2
LATIN AMERICA EPZ AND EPZ-STYLE PROGRAMS (/1)

Country	Number of Operating Enterprises	Number of Operating Zones				Number of Zones Designated, Planned, or Under Construction	Number of Future Private Zones	Direct Employment	Annual Exports (US$ millions)
		Private	Public	Mixed	Total				
Bahamas	40	1	1	0	2	0	0	8,000	40
Barbados	100	0	11	0	11	0	0	20,000	140
Belize	0	0	0	0	0	1	1	0	0
Brazil (/2)	0	0	0	0	0	10	0	0	0
Colombia	40	0	6	0	6	3	0	7,000	42
Costa Rica	80	6	1	0	7	2	2	7,500	100
Dominican Republic	400	11	13	1	25	9	7	142,000	825
El Salvador	9	0	1	0	1	1	1	3,500	26
Guatemala	50	1	1	0	2	5	5	1,100	5
Haiti	140	0	2	0	2	0	0	40,000	108
Honduras	38	3	1	0	4	4	3	11,400	30
Jamaica	25	0	3	0	3	1	0	11,300	110
Mexico	1,997	51	74	10	135	8	5	482,000	12,700
Panama (/3)	10	1	1	0	2	2	2	2,000	10
Peru	0	0	0	0	0	n/a	n/a	0	0
Puerto Rico	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
St. Lucia	6	0	2	0	2	0	0	1,500	4
Trinidad	0	0	0	0	0	2	0	0	0
Uruguay	0	0	0	0	0	1	1	0	0
Totals	2,935	74	117	11	202	49	27	737,300	14,140

Note: n/a = Not available

(/1) The commercial free zones of Aruba, Chile, Curacao, and Venezuela are not included. Also not included is the inactive EPZ of Nicaragua.

(/2) The import-processing zone of Manaus has not been included.

(/3) The Colon Free Zone is also a significant transshipment center.

TABLE 2-3
AFRICA AND MIDDLE-EAST EPZ AND EPZ-STYLE PROGRAMS (/1)

Country	Number of Operating Enterprises	Number of Operating Zones				Number of Zones Designated, Planned, or Under Construction	Number of Future Private Zones	Direct Employment	Annual Exports (US$ millions)
		Private	Public	Mixed	Total				
Cameroon	0	0	0	0	0	1	1	0	0
Dubai (/2)	300	0	1	0	1	0	0	11,000	100
Egypt	262	0	6	0	6	3	0	18,000	90
Kenya	0	1	0	0	1	2	0	0	0
Liberia	0	0	1	0	1	0	0	0	0
Madagascar	16	0	0	0	0	1	1	1,000	4
Mauritius	570	11	20	0	31	n/a	n/a	89,000	6-12
Senegal	10	0	1	0	1	0	0	600	15
Togo	8	0	0	0	0	2	2	400	4
Tunisia	600	0	14	0	14	n/a	n/a	40,000	500
Turkey	533	0	2	0	2	2	2	130,000	700
Totals	2,299	12	45	0	57	11	6	290,000	2,055

Note: n/a = Not available

(/1) The commercial free zones of Bahrain, Morocco, Jordan, Cyprus, Djibouti, and Syria are not included. Also not included are inactive EPZ programs such as Zaire and Lebanon.

(/2) The Jebel Ali Free Zone is also a significant transshipment center.

b. IFZ Industrial Estates

2.37 If an industrial estate is to be created for IFZ firms, the question of who will develop and manage the zone arises. There is a wide range of alternative ownership frameworks for IFZs. The key factor is not whether the zone is owned by the public, private, or mixed sector, but whether the zone is sensitive to the needs and demands of zone users. Although the government is responsible for establishing and enforcing the incentive and regulatory regime, the ownership and management of zones is essentially a variation of industrial real estate development which is normally open to the private sector. The various alternatives are as follows:

Fully Private Zones. The experience of IFZ-sponsoring countries indicates a preference among foreign investors for zones that are developed and managed on a completely private basis. The preference for private zones appears to arise from the disparities between the public and private sector in terms of their performance as zone managers. Foreign investors in Costa Rica and the Dominican Republic regularly choose to base their operations in private zones despite significantly higher rental rates.

The willingness of zone users to pay higher rents is based on the perception that a private zone yields a better long-term value and a higher degree of service. In contrast to publicly owned and operated zones, private IFZ developers have risked their own capital and thus have a greater incentive to provide a quick, high quality response to zone user needs. In addition, private zones typically offer a wider range of services including private health care facilities, job data banks, and landscaped surroundings.

Public/Private Partnerships. A more active public sector role is found countries such as Turkey, Hong Kong, and the People's Republic of China. A variety of partnership configurations include:

- contracting private management for a government-owned zone;
- joint equity ventures between the public and private sectors;
- long-term lease of government-owned land to a private developer;
- "build-operate-transfer" agreements under which a private investor develops and manages an IFZ for a predetermined time period. Within this time frame, the developer is able to recover all capital and operating costs from the rents collected. At the end of this period, the ownership of the zone is transferred to the public sector.

Fully Public Sector Zones. The public sector has traditionally played an active and effective role in the development and management of IFZs in countries such as South Korea, Malaysia, and Taiwan. However, the experience of most recent IFZ-sponsoring countries indicates a strong trend toward greater reliance on privately operated zones. Given the performance of most state-owned enterprises, as well as the limited quantity

of public funds, IFZ industrial estate development is increasingly being done by the private sector.

2. Emerging Trends

2.38 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.

2.39 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. Following this trend, public sector IFZ/industrial estates have been privatized in Costa Rica with divestiture being discussed for public sector zones in Guatemala, the Dominican Republic, and Senegal.

2.40 In terms of future trends, it is likely that privately developed and operated IFZ industrial estates will continue to play a greater role. The financial and economic performance of IFZ industrial estates outside of Asia have been largely disappointing compared to their private sector counterparts. Private sector zones have tended to be better designed, better constructed, better maintained, and better promoted than zones operated by the public sector. Moreover, private sector zones are increasingly installing private electricity and telecommunications networks so as to provide higher quality services to tenants as well as reducing the capital costs to financially strapped governments.

3. Development Benefits

2.41 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.

2.42 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.

2.43 If properly implemented, IFZ programs can have immediate economic benefits. These are the most readily accrued in the form of creating jobs, transferring technology, 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 3 percent in 8 years. The Mauritian IFZ program currently employs approximately 90,000 workers and generates US$642 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 142,000 in 1991. In 1990, Dominican IFZ exports reached US$825 million.

2.44 IFZ programs can also generate significant indirect employment through the provision of local materials and services. In the first phase of an IFZ program, indirect employment is typically created in repair services, business services (ranging from legal and accounting services to printing and copying), transportation of workers and goods, security services, maintenance services and other activities.

2.45 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.

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 Asian 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.

3.09 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 1988, 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.

3.10 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.

3.11 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 Southeast Asia, 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.

3.12 The cost competitiveness of the Asian 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.

3.13 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

3.14 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 some 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

3.15 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 1987), 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.

3.16 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.

3.17 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.

3.18 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 as high as 80 percent for some companies in the United States.

3.19 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

3.20 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.

3.21 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.

3.22 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.

3.23 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.

3.24 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. Similarly in the Dominican Republic, only 26 of the 400 IFZ firms are in the electronics sector.

3. Light Manufacturing Sector

3.25 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.

3.26 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 Products and Fishery Sector

3.27 The spectrum of activities encompassed by the processing of natural products 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 promise for successful development in economies which have a substantial agricultural or fishery base.

3.28 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.

3.29 Typically, agro- and seafood-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 for agro-processing activities. Both the export of primary agricultural produce as well as agro-processing activities typically require refrigerated storage and utilize unskilled labor.

3.30 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 1988, 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$258,000. 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 the late 1980s, the 14 food packing and canning companies operating under this regime averaged US$2.75 million in value-added per company as well as employing a total of 2,185 employees.

3.31 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.

3.32 Overall, however, free zone regimes have been largely unsuccessful in promoting the development of agro- and seafood-industry in LDCs. In 1990, for instance, less than 9 percent of exports from the Dominican Republic free zone regime were agro-industrial in nature (if tobacco related industries are included). This relatively low level of agricultural activity is common to most IFZs throughout the developing world. Seafood-processing industries are even less common throughout the Caribbean Basin. Among the IFZ programs of the Dominican Republic, Guatemala, El Salvador, Jamaica, and Costa Rica, there is only one seafood processing firm. However, four of the approved firms in the Togolese IFZ program are seafood related as is one of the eight operational firms in the Senegalese IFZ.

5. Informatics Sector

3.33 Informatics refers to a broad range of information processing activities, from the straightforward keypunch entry of data by typists to the sophisticated development of customized software systems. Within this spectrum of activities, the labor intensive data entry segment has come to play an important role in several LDC economies in much the same way as the assembly of garments. At the more skill-intensive end of the spectrum, the presence of highly trained nationals combined with improved telecommunications systems is allowing LDC based firms to market themselves internationally.

3.34 Over the last twenty years, as firms in the industrialized world began to shift more operations onto computers, demand arose to convert historical records and hand written information into machine readable computer files. Specialized data entry service bureaus arose in many locations to provide these services.

3.35 Because labor costs represent between 50 to 80 percent of the cost for these services, there is a strong incentive to perform these activities in a lower wage location. During the course of the 1980s, firms began to move operations offshore. The limiting factors of turn around time and transportation, meant the initial offshore locations tended to be very close to their markets or on major transport routes. For the U.S. market this meant the Caribbean emerged as the primary market for data entry, with Barbados, Jamaica and the Dominican Republic accounting for about 5,000-10,000 data entry jobs by the end of the decade.

3.36 A typical operation involved the air freight transport of documents to the production facility, keypunching and return of magnetic tapes or disks within a period of several weeks. Improvements in telecommunications have resulted in operations which receive raw material for processing via high speed facsimile and delivery to customers within a turnaround time of several hours.

3.37 At higher levels of added value are such refinements as the construction of Computer Aided Design (CAD) graphic databases, voice center operations (such as order processing centers, reservation centers, telemarketing, etc.), and the development of custom software systems. While informatics industries in general still account for relatively small employment levels world-wide, the increasing needs of the rapidly growing tertiary industries make this a sector with considerable future potential for IFZ programs.

D. PREFERENTIAL MARKET ACCESS

3.38 The growth of offshore manufacturing, and the geographic and sectoral composition of trade, has been influenced to a certain 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 mixed, with the impact of a number of preferential regimes for imports from developing countries counterbalanced by exclusion of goods which are typical LDC exports, limitations for disruptive domestic impact in the industrial countries, and sectoral protectionist measures. In some industries with sector-specific trade agreements such as in textiles and apparel, the impact has been mixed, limiting export growth from established producers and encouraging dispersion to new production locations. The principal trade agreements governing trade between industrial and developing countries which apply to Cape Verde are summarized below.

1. European Markets

3.39 **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 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 four-digit tariff classification.

3.40 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.

3.41 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.

3.42 **European Generalized System of Preferences (EC/GSP).** This program of the European 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. However, this scheme is generally not used by ACP nations as the conditions under the Lomé Convention are more favorable.

2. United States Markets

3.43 Cape Verde is eligible for tariff relief and preferential access to the American market under the U.S. Generalized System of Preferences, which is similar to that in Europe. Additionally, Provision 9802 of the U.S. Harmonized Tariff Schedule also allows for duty relief on U.S. sourced materials which are processed offshore. While Cape Verde's exports are eligible for tariff relief under these programs, the United States does not hold much potential as a market for Cape Verdean exports until large improvements are made in the transport connections

between the two countries. The restoration within the near future of New York/Sal Island/Johannesburg flights by South African Airlines could open up possible markets for high value/weight items.

3.44 **U.S. Generalized System of Preferences (U.S. GSP).** The U.S. GSP was initiated in 1974 to allow more than 10,000 manufactured products from all (non-communist) developing countries to enter the U.S. market free of duties. In order to qualify for GSP provisions, the product must meet certain requirements: (i) the sum of the cost or value of the materials produced in the beneficiary country plus the direct cost of processing must equal at least 35 percent of the appraised value (ex-factory price) of the article;[1] (ii) the only way imported materials may be counted towards the 35 percent value-added calculation is if the merchandise "is substantially transformed into a new and different article of commerce" according to U.S. Customs law; and (iii) the article must be imported directly into the U.S. from the beneficiary country.

3.45 Selected products are excluded from GSP duty-free benefits because of the potential adverse impact upon domestic U.S. industries. For example, certain specified electronic products and components from beneficiary countries; some types of import sensitive electronic products are ineligible for GSP status because their duty-free importation would be detrimental to U.S. producers. Other such products include: textile and apparel products subject to textile agreements; watches; import-sensitive steel articles; footwear, flatgoods and leather apparel; and certain import-sensitive glass products. In 1987, GSP trade reached US$16.3 billion, of which US$9.7 billion was generated by the four Asian NICs. In 1989, however, these four countries "graduated" from the GSP Program and are no longer eligible for GSP benefits. As a result, total GSP trade declined to US$11.1 billion by the end of 1990. Imports from five countries represented 65 percent of total GSP imports; Mexico and Brazil together accounted for US$3.9 billion, with aggregate imports under this program from Malaysia, Thailand, and the Philippines totaling US$3.3 billion.

3.46 **Provision 9802 of the U.S. Harmonized Tariff Schedule.** Previously known as provision 806/807 of the U.S. Tariff Schedule, HTS 9802 admits products assembled from U.S.-made components into the U.S. market with duties imposed only on the non-U.S. value-added of the processing undertaken outside the United States. Therefore, if a product has an appraised value of US$100, and the total foreign value-added was US$40, U.S. duties would apply only to the US$40. All non-communist countries qualify for the tariff provisions. Currently, over 2,000 U.S. companies reduce their production costs by assembling U.S. components in low wage locations offshore for re-import to the U.S. under the program. By 1989, the total value of U.S. 9802 imports reached US$73 billion, with Canadian and Japanese imports accounting for 35 and 23 percent of U.S. 9802 imports respectively. Mexico's share comprised 16 percent of the total, with European imports at 12.2 percent, other Asian countries at 9.5 percent, and 3.4 percent from

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1 Eligible costs in calculating the 35 percent value-added requirement include the following: actual cost of materials and components; freight, insurance and packaging; cost of spoilage or waste; taxes and/or duties imposed on materials; as well as direct costs of processing the product including labor, R&D costs, among others.

Caribbean Basin countries. Unlike the U.S. GSP program, the 9802 provisions cover apparel and textile products.

3. Regional Market Access

3.47 Cape Verde is a member of the Economic Community of West African States (ECOWAS, or as it is known in Portuguese, CEDEAO) which has as its goal the economic integration of its 15 member states. However, the achievements of ECOWAS have been limited to date, and its future is complicated by the existence of other regional groupings. Currently there are thirty-two integration schemes of one sort or another in West Africa, although the principal rival to ECOWAS in West Africa is the francophone Economic Community of West Africa (CEAO). The French-inspired CEAO membership includes Ivory Coast, Mali, Mauritania, Niger, Senegal Burkina Faso, and Benin. The existence of the CEAO has often been credited with hampering the full implementation of ECOWAS integration measures and in particular preferential trade measures, as members see little advantage to the wider grouping and a possible loss of benefits from France, which has supported the CEAO.

3.48 **ECOWAS.** This group was formed in 1975 and is the most vigorous attempt at regional integration in Africa to date. It comprises 16 West African countries-Anglophone, Francophone, and Lusophone-ranging in size from Nigeria with a population of 100 million, to Cape Verde, with a population of 350,000. At present, ECOWAS members include Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, The Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Mauritania, Niger, Nigeria, Senegal, Sierra Leone and Togo. While the aims and aspirations of ECOWAS are broad and ambitious, the primary objective of ECOWAS is to raise the standard of living of its people. The Community was formed to establish a single market in West Africa and encourage regional economic integration.

3.49 Trade liberalization is one of the main objectives of ECOWAS. External tariffs were to be frozen first, followed by a reduction on tariffs on goods produced within the Community, and finally the establishment of a common external tariff and the free movement of goods, persons, and capital within ECOWAS. The creation of a common market was intended to stimulate investment, trade and self-reliant development among member-states.

3.50 Implementation of the trade measures has been slow, however. For the past 10 years, the Community has been finalizing preparation for the take-off of this scheme. Some progress, though gradual, has been made toward this end. In May, 1979, all Customs duties and taxes, as well as all non-tariff barriers on goods originating from the Community, have been consolidated and frozen by each member state. In 1981, tariffs on all unprocessed goods or handicraft product originating from the Community were eliminated. In other words, the first two categories of Community-originating goods (unprocessed goods and handicraft products) cease to attract any tariff within the Community if accompanied by an ECOWAS Certificate of Origin.

3.51 Non-tariff barriers to intra-Community trade are scheduled to be removed completely over a four-year period by each ECOWAS Member State. The specific rate at which these non-tariff barriers will be removed has been determined by individual member states. The goal is that by January 1, 1994, non-tariff barriers on Community-originating goods would have been eliminated throughout West Africa. The Community has also agreed on a clear definition of non-tariff barriers and has adopted a list of such non-tariff barriers.

3.52 These initial steps to liberalization are to be followed by a progressive elimination of tariffs over a nine year period on all industrial products. The principals for preferential treatment of qualified goods have been established, and were implemented on January 1, 1990.

3.53 All industrial products seeking ECOWAS preferential trade status must be accepted by ECOWAS. To qualify, firms must have a minimum of 20% local capital to be considered ECOWAS originating. Products must have either 40% value added in ECOWAS or 60 percent of their raw materials must be sourced from ECOWAS countries. Additionally, a certificate of origin is needed. The elimination of tariff barriers will be more gradual and the rate will depend on the category to which the product and the exporting Member State belong. Industrial products have been divided into two groups: priority and non-priority. The rate of tariff reduction is faster for the priority industrial products. In all cases, these industrial products, and the enterprise manufacturing them, must have successfully passed through the selection and approval procedure laid down by the ECOWAS Council of Ministers in June, 1988.

3.54 The 16 ECOWAS member states have been grouped into three, according to their level of industrialization. The first group, with relatively the highest level of industrialization, comprises Côte d'Ivoire, Ghana, Nigeria, and Senegal. These countries are required to eliminate tariffs fastest: over a four-year period for the priority products, and in six years for non-priority products. The next group of countries is made up of Togo, Benin, Guinea, Liberia and Sierra Leone. These Member States are expected to eliminate all tariffs on priority industrial products over six years, and in eight years for non-priority products. The last group, accorded the slowest rate of tariff elimination, covers Burkina Faso, Cape Verde, The Gambia, Guinea-Bissau, Mali, Mauritania, and Niger. Their rate of tariff elimination is eight years for priority products and 10 years for non-priority products.

3.55 On priority industrial products, tariff elimination is spread over 8 years on the basis of a 12.5 percent reduction per year for group 1 countries, 6 years on the basis of 16.6 percent reduction per year for group 2, and 4 years on the basis of 25 percent reduction per year for group 3 (includes Cape Verde). On non-priority industrial products, the elimination is fixed for group 1 at 10 percent reduction each year for ten years, for group 2 at 12.5 percent reduction each year for eight years, and for group 3 (includes Cape Verde) at 16.6 percent reduction each year for six years.

3.56 From Cape Verde, two products produced by SOCAL have qualified for treatment as priority industrial products. These are "natural leather shoes" and "synthetic leather shoes". To date these trade advantages have not been utilized.

3.57 Recognizing that the less developed countries would be the least likely to benefit from membership in the Community in the short run, the ECOWAS Fund for Cooperation, Compensation, and Development was set up to compensate those countries losing revenues and to finance specific development projects in member states. The provision provides for fiscal compensation for revenue losses incurred in the process of trade liberalization. Other provisions have been structured so as to approximately compensate the least developed member states for the "impact" of national income losses (reflected in tariff revenue losses) which they incur as a result of trade diversion.

3.58 Under this revenue compensation scheme, bilateral trade imbalances will be compensated with payments from the surplus countries to deficit countries, through the Fund, for the amount of lost revenues resulting from the tariff concessions. While the preferential tariffs may be an advantage for producers locating in Cape Verde, the compensation scheme may pose problems to the degree that the free zone program is successful and Cape Verde becomes a net exporter of manufactured goods to the region.

3.59 In this case Cape Verde will be required to pay into the Fund to support firms exporting from the free zone to ECOWAS member countries. Yet the government will be generating very little in direct tax receipts from those companies. The result could be a net drain on the Treasury. However, given the modest potential for Cape Verdean exports to West Africa, it is doubtful that this would be a large drain on national resources.

3.60 Even assuming the successful introduction of preferential tariffs on industrial goods, other obstacles act to constrain the development of a unified African market. These obstacles may prove more fundamental to increasing intra-regional trade in general and to individual firms establishing in Cape Verde to serve regional markets. Some of the principal obstacles include:

- poor communications: telephone and mail service is expensive and/or unreliable among West African states, especially when compared to communications with Europe;

- poor transportation links: similarly, shipping and air cargo services are not well developed;

- administrative barriers: in spite of the effort to reduce non-tariff barriers, they remain pervasive in many forms, including import licensing, foreign exchange controls and bureaucratic inefficiencies in Customs and other services. These factors have contributed to the pervasiveness of informal trade among countries in the region.

3.61 These factors have constrained the development of a unified West African market, and will prove difficult to overcome in the near term. Their combined effect has been to promote an evasion of formal trade channels for the intra-regional trade which does exist, and to sustain the existing trade relationships with industrial countries, which can usually supply imports less

expensively than other West African states. Moreover, if and when the CFA franc is devalued, Francophone countries will instantly become much more competitive, as the currency is significantly overvalued according to most economists.

3.62 Thus, for an industrial free zone in Cape Verde, regional markets will have a limited potential. Until the ECOWAS tariff agreements are actually implemented, there is no special advantage in terms of market access to firms locating in Cape Verde versus other ECOWAS countries, particularly given the better regional transportation and communication links available on the continent, equivalent incentives in Togo, and less expensive labor in Nigeria, Ghana, and Togo.

3.63 Similarly, given the minimum value tolerance levels required, Cape Verde has no particular advantage to non-ECOWAS investors as a base for re-exports. In this matter, CFZ activity does not qualify for ECOWAS benefits.

3.64 Potential markets within ECOWAS will be of more interest as secondary or expansion markets, than as primary markets. Thus for import-substitution companies such as SITA or INFARMA, or for export oriented companies targeting the European market such as SOCAL, the start of export operations to ECOWAS members can be a useful initiative. Start-up firms with business plans looking at West Africa as the primary market will be confronted with the administrative and other difficulties noted below.

3.65 It should be emphasized that IFZ sales to regional developing country markets are extremely small. IFZ programs in the Caribbean, Central America, and Indian Ocean generally have less than five percent of their production sold in neighboring developing countries. When they do occur, regional sales from IFZ firms have been more common outside the typical IFZ sectors of apparel and leather footwear. Senegalese IFZ firms sell plastic shoes, wigs, pharmaceuticals, and bicycle parts while Togolese IFZ firms are -- or will be -- selling regionally products such as metal paint cans, steel, ship and plane repair, veterinary products, and cosmetics. The large percentage of firms that sell regionally in Togo and Senegal is therefore unusual; however, it should be emphasized that Togo's and Senegal's transportation and telecommunications links within the region are much better than those of Cape Verde's.

4. Internal Market

3.66 Under the Industrial Development Statute, export-oriented firms can sell up to five percent of their production locally, with greater amounts permitted when in the interest of the country. For IFZ firms, sales to the local market are usually a relatively unimportant factor, particularly in a country with as small a market as Cape Verde's. Because IFZ firms are so specialized, they typically produce only one or two items. For such a firm, one or two day's production can often be sufficient for the country's annual needs especially as the goods produced are usually of similar styles, patterns, etc. Because of this, Cape Verdean demand for imported merchandise such as apparel, footwear, handbags et al would likely continue,

particularly given the large number of products sent from overseas relatives and the existence of Cape Verde's Senegalese traders. Local sales from IFZ firms have tended to be more important to firms in less typical sectors such as pharmaceuticals and agro-processing. In fact, Senegal recently modified its IFZ law to permit up to 40 percent local sales because of strong market demand in sectors such as wigs, bicycle parts, pharmaceuticals, and plastic shoes.

E. SUMMARY

3.67 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. Cape Verde can conceivably capture some of this industrial activity, depending on its factor endowment relative to competitors. In this effort, Cape Verde will be competing globally with other developing countries, not just those of West Africa who may appear to be their natural competitors. The comparative advantages and disadvantages of Cape Verde in entering this international competition for industrial investment in free zone activities will be explored in the following chapters.

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

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.

1. 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.

2. 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.

3. 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.

4.09 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.

4.10 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

4.11 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.

4.12 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.

4.13 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.

4.14 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 countries with controlled (and overvalued) exchange rates, a two-tiered exchange rate system has been

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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.

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.

4.15 Beyond these core incentives, a number of legislative innovations have been made recently. These include:

1) Private sector groups have been allowed to develop and manage multiple IFZs in the Dominican Republic, Mauritius, Costa Rica, Indonesia, Thailand, Togo, and Cameroon. Private sector owned zones have exhibited a much higher success rate than their public sector counterparts due to the better facilities and services offered. In addition, the existence of private sector zones can lead to a faster start-up and a reduction in government expenditures for the development of zone facilities and infrastructure. It is becoming increasingly common for zone developers to be granted the same incentives as zone tenants. One reason for this is that leases are often denominated in foreign currency. The availability of the zone incentive package provides strong inducement to the creation of private IFZs.

2) Allowing for private utility provision. In the Dominican Republic, zones are allowed to offer private electricity and telecommunications service. This has clearly improved the level of infrastructure available while reducing operating costs for zone tenants. The availability of private telecommunications service has reduced international telecommunications costs by as much as 80 percent in some countries. This reduced price could potentially make Cape Verde a viable location for export of labor-intensive data capture and other information services activities.[2]

3) Flexibility in choosing locations. While IFZ industries have traditionally been found in industrial-estate style-zones, a number of IFZ countries are now allowing firms with zone status the choice of either locating in an industrial estate or as a single-factory free zone (SFFZ). This flexibility is viewed positively by potential investors who may wish to site near a raw material or transport mode far from existing

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2 In regards to Cape Verde's concern over the present lack of tertiary educational facilities, private telecommunications services may also foster the development of teleuniversities.

industrial estate-style zones. While this approach allows for dispersal of zone benefits throughout the country, it is often more difficult and expensive to administer. The dual approach -- combining estate-style IFZs with the option of single-factory designations -- is offered in a number of countries including Costa Rica, Mauritius, Togo and Cameroon.

4) Ability to sell a percentage of production locally. Although IFZs are targeted for exports, a number of countries allow firms to sell to the local market. In Costa Rica, for example, firms are permitted to sell up to 49 percent of their production locally, paying full duty as imports to prevent unfair competition to local producers. In general, zone programs allow 10-20 percent of production to be sold locally.

5) The sale of goods and supplies from local firms to IFZ firms are similarly considered exports. Many countries offer partial export regimes to firms that cannot attain the levels necessary for IFZ status. These benefits can take the form of reduced duties, income taxes, etc. By considering local sourcing to zone firms as an export, the development of backward linkages can be increased, given the proper incentives to partial exporters. In addition, this mechanism will generate added foreign exchange to the country, as purchases would be made in local currency.

6) Linkages between IFZs and technical training institutions of the sponsoring country. Because practical business and management skills are often in short supply, IFZ developers have increasingly worked to establish links between zone industries and nearby training centers. The San Cristobal (Itabo) zone in the Dominican Republic, for example, has established customized courses in cooperation with the Loyola Institute, and the Cartago Free Zone in Costa Rica has made a building available to INA, the national training program, for zone-based courses.

4.16 In addition to the two sets of incentives listed above, many countries offer additional -- and typically ineffective or even detrimental -- incentives to IFZ firms. The most common of these include:

- 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.

4.17 These so-called 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

TABLE 4-1
COMPARISON OF EXPORT INCENTIVES IN SELECTED COUNTRIES

	Cameroon (IFZ)	Dominican Republic (IFZ)	Mauritius (IFZ)	Togo (IFZ)	Cape Verde (EIC)
Corporate Income Tax Abatement	100% exemption for the first 10 years; 15% tax thereafter	100% exemption for 8-20 years depending on location	15% tax rate	100% exemption for the first 10 years; 15% tax thereafter	100% exemption for the first 10 years; 15% tax thereafter
Capital/Profits Repatriation	Unrestricted	80-100% exempt depending on location	Unrestricted	Unrestricted	Guaranteed to external investors of non-Cape Verdean nationality
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	30	30
Tax on Dividends	100% exemption in perpetuity	80-100% exemption depending on IFZ location	100% exemption for 10 years	100% exemption in perpetuity	Yes, but time period not specified
Sales to Local Market	Variable; decided on a case-by-case basis	20% of total output	10% of total output	20% of total output	5% of total output
Management of Foreign Currency	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted

Source: Compiled by TSG

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

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

4.19 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

4.20 **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.

4.21 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.

4.22 **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.

4.23 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.

4.24 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.

4.25 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.

4.26 **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.

4.27 **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.

4.28 **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.

4.29 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

4.30 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 Corporación 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.

4.31 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

4.32 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.

4.33 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.

4.34 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 Zone 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

4.35 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.

4.36 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.

4.37 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.[3] 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.

4.38 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

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3 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.

control, and the need to expedite the transit of goods into and out of IFZs. In addition, some IFZ programs ensure control not through physical means but through documentation procedures.

V. ECONOMIC FACTORS INFLUENCING THE POTENTIAL FOR THE ESTABLISHMENT OF AN INDUSTRIAL FREE ZONE PROGRAM IN CAPE VERDE

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 Cape Verdean environment for the establishment of an industrial free zone program in terms of its infrastructure, transportation, and other attributes.

A. OVERVIEW OF NATIONAL ECONOMIC ACTIVITY

1. Macroeconomic Climate

5.02 Cape Verde attained its independence from Portugal in 1975, and entered this period with a per capita income around US$200. Through a combination of sound fiscal management, expatriate remittances, and foreign assistance the economy (GDP) of Cape Verde grew at a rate of seven percent annually through 1990, reaching a per capita income of over US$600 by the end of this time.

5.03 In the initial years after independence the country struggled to deal with basic needs, and to address the effects of a drought which lasted from 1968 through 1984. As the country met with some success in these efforts, a desire to strengthen the industrial sector led to a strategy of import substitution with public enterprises playing a key role. In the late 1980s, the government began shifting its policies to liberalize the economy and promote stronger involvement of the private sector.

5.04 The new MPD government, which came to power in elections held in early 1991, has affirmed its support for the continued liberalization of government policy toward industry. The policy program of the new government calls for support of both export oriented and import substitution firms. To the extent that support for import substitution is limited to the benefits defined in the Industrial Legislation (and does not expand to include protectionist measures against competing imports or subsidies to inefficient local producers), then this support for both export oriented and import substitution firms is not incompatible. In fact, given the new government's decision to follow both import-substitution and export-oriented policies simultaneously, an IFZ program is the best option for balancing these two divergent policies.

5.05 The economy of Cape Verde is unusual in its dependence on external financial flows. As shown on Table 5-1, external transfers represent over one half of the GDP in 1986 (the latest year with complete statistics). In straight forward terms this means that one third of the national income comes from people outside the country transferring this money to Cape Verde. While

it is fortuitous to receive these transfers, sensible policy making should orient the country to a path which will permit less dependence on external assistance.

TABLE 5-1
GDP AND EXTERNAL TRANSFERS, 1980-1986
(millions of CVE, current prices)

Year	GDP	External Transfers	of which: Public	of which: Private	Transfers/ GDP
1980	5,715	2,955	1,541	1,414	52%
1981	6,719	2,876	1,235	1,642	42%
1982	8,199	4,088	2,337	1,751	50%
1983	9,929	5,100	2,810	2,290	51%
1984	11,209	6,091	4,495	1,596	54%
1985	12,625	6,860	5,045	1,815	54%
1986	15,286	8,417	6,392	2,024	55%

Source: Boletim Anual de Estatistica, Direccao Geral de Estatistica, 1989, pg 148.

5.06 While the national income accounts show a marked dependence on external transfers, the foreign trade accounts show an even greater dependence on the transfers to maintain a balance (as shown in Table 5-2). Through the period 1983-88, the import coverage ratio averaged only 4.8 percent and never even approached 10 percent. To the credit of the government, excessive foreign borrowing was not used to close this gap. Consequently, over 90 percent of Cape Verdean imports are paid for by foreign exchange coming from sources other than exports of goods, mainly external transfers. Again, while the situation is fortunate, it is necessary to plan for achieving balance in the absence of future assistance.

TABLE 5-2
EXPORTS, IMPORTS AND IMPORT COVERAGE RATIO, 1983-1988
(millions of CVE, current prices)

Year	Exports	Coverage Imports	Ratio
1983	246	6,217	4.0%
1984	212	7,011	3.0%
1985	524	7,605	6.9%
1986	355	8,601	4.1%
1987	561	8,596	6.5%
1988	241	8,626	2.8%
1989	527	8,706	6.1%

Source: Boletim Trimestral do Comercio Externo, Direccao-Geral de Estatistica, 1989 No. 2, pg. 3.

5.07 The volume of exports from Cape Verde is so low that speaking of trade patterns almost does not make sense. Average annual exports over 1983-89 were CVE357 million (US$5 million), but this figure fluctuated dramatically, doubling in some years and dropping by one-half in other years (see Table 5-2 above).

5.08 Exports can almost be followed on a transaction by transaction basis. In the most recent year for which complete data are available (1989), 79 percent of total exports are accounted for by sales to two countries, Algeria and Portugal.[1] Moreover, only two products (frozen fish to Algeria and bananas to Portugal) account for 77 percent of total exports. "Semi-finished" and "Industrial" exports (ECOWAS/SITC Sections VI-XIX) represented only 2.5 percent of total exports.

5.09 The wide fluctuations in this data make it difficult to speak of trends. Europe consumed 49 percent of Cape Verde's exports between 1983-88, but this proportion ranged from

1 BTCE, op cit, pp 7-27.

23 percent in the lowest year to 94 percent in the highest. Africa consumed 46 percent of exports, varying from 6 percent to 71 percent of consumption, depending on the year.

5.10 Imports, as they generally average twenty times the value of exports, show greater consistency. Over the 1983-89 period imports averaged CVE7,908 million (US$113 million).[2] Using figures from 1989, Portugal is by far the largest trading partner with 30.7 percent of total imports, followed by Holland at 8.8 percent and Japan at 6.2 percent. All other countries have less than 5 percent each of Cape Verde's import market.

5.11 A third important point to note about the structure of the Cape Verdean economy is the strong dependence on the tertiary (i.e., services sector) and the relatively small role played by "Transformative Industry". The primary sector, which includes agriculture and fisheries, accounts for between 11 and 18 percent of GDP. As can be seen from Table 5-3 below, the primary sector has been subject to wide variation (note the low point during 1982-84, the last years of the drought). Nearly one half of the tertiary sector activity comes from retail commerce. Finally in the secondary sector, which includes industry and transformative enterprises, roughly two thirds of the activity comes from construction. "Transformative Industry", which includes typical free zone sectors such as garment assembly, shoes, etc., represents around only one percent of the GDP.

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2 BTCE, op cit, pp 29-49.

TABLE 5-3
SECTORAL CONTRIBUTION TO GDP, HIGHLIGHTING INDUSTRY
(millions CVE, constant 1980 prices)

Year	Primary Sector	Secondary Sector	|--------of which--------| Transf. Indus.	Tertiary Sector	TOTAL
1980	1,067	962	50	3,326	5,715
1981	1,008	1,066	52	3,761	6,198
1982	799	1,068	49	4,087	6,373
1983	795	1,248	76	4,418	6,980
1984	810	1,241	74	4,675	7,244
1985	1,033	1,423	130	4,866	7,870
1986	1,107	1,450	98	5,003	8,096

Source: Boletim Anual de Estatistica, Direccao Geral de Estatistica, 1989, pg 147.

5.12 Exchange rate policy is a crucial element for a country embarking on an export-oriented development strategy. Historically the Cape Verdean approach has been a conservative and realistic one, which when combined with an equally conservative monetary policy, has lead to a sound financial sector. The Cape Verdean Escudo is pegged against a trade-weighted basket of currencies. A restrained growth of credit has kept inflation to an average annual rate of just 6.3 percent over the period 1985 - 1989. Similarly, inflation in 1990 was estimated at 8.7 percent. In combination with the balance of payments support provided by the previously discussed external transfers, relatively low inflation has resulted in little pressure for adjustment of the parity.

5.13 The BCV, together with other observers, feels that there is a slight overvaluation at present. The most recent IMF mission in the country (spring of 1991), estimated the overvaluation at 5-7 percent. The parallel market for foreign exchange is currently the same level as the official rate. Consequently, the overvaluation of the CVE would only be represented by the transaction cost.

5.14 Recently, some observers have argued that the escudo is overvalued based on the fact that factor costs in Cape Verde (as will be seen later in this chapter) are relatively high. As a

result, the idea of establishing a dual/preferential exchange rate to assist exporters has been introduced.[3] The reasoning for this policy action is that the economy cannot absorb the inflationary shock of adjusting the exchange rate to eliminate the overvaluation.

5.15 Generally, the introduction of a dual exchange rate is done in countries with drastically overvalued currencies, as a means of providing a short-term solution to a highly unpopular, but necessary, devaluation. The parallel market in Cape Verde gives no evidence that this is the case. The establishment of dual exchange rate in Cape Verde could therefore erode one of the country's historical advantages, a sound and conservative approach to monetary management. Other measures which directly address the root causes of high factor costs, such as inefficient public sector monopolies, will be more effective and less distortive than introducing a dual exchange rate system for exporters.

5.16 On a practical basis, the introduction of a dual exchange rate would be extremely difficult to manage, involving complex decisions on the allocation of costs for firms exporting a portion of their production. It is inadvisable to create a system subject, by nature, to political pressure in its' application. The question of overvaluation should be carefully re-evaluated in consultation with the IMF, and if necessary a change should be made in the means of determining the exchange rate. Such a change would preferably involve a means of adjusting periodically the exchange rate based on factors of supply and demand.

5.17 To summarize, the Cape Verdean economy, while it has been reasonably well managed, exists in a precarious situation due to its extreme dependence on external transfers. Recognizing this, and recognizing the small role currently played in the economy by industry, both the PAICV and MPD governments have made attempts over the past few years to stimulate industrial activity (see Chapter VI.A. for a discussion of these policy initiatives). The goals of these policies include diversification of the economic base within the country and the promotion of exports. Given the modest base of industrial production (only US$1.4 million in 1986 for "Transformative Industry") and the modest base for exports (only US$3.4 million in 1988 for goods) success in these policies will similarly be measured modestly in absolute terms.

2. Current Levels of Manufacturing Activity

5.18 Between independence and 1987, the GOCV undertook a substantial import-substitution effort in the industrial sector. As a result, growth of the industrial sector in the 1980s had an annual average growth rate of over three percent a year. Despite this growth, this strategy has had its shortcomings. First, because of the small size of the domestic market, locally oriented Cape Verdean industries have typically operated at 25 percent of capacity and have been unable to achieve any economies of scale. Second, the import-substitution focus has encouraged firms to ignore the potential in exporting to overseas markets. As a result, industrial export activity

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3 The idea was presented in one form in: "Elementos para a Definacao de uma Politica Comerical"; Secretaria de Estado do Comercio e Turismo; Nov. 20, 1990; pg. 10.

in recent years has largely been limited to two firms, SOCAL in shoes and MORABEZA in garments, which are attempting to re-orient themselves from their original import-substitution foci to export-driven strategies.

5.19 There are a total of 534 firms in the secondary (industrial) sector. The vast majority of these firms are small and most are concentrated in three areas: there are over 200 bakeries, nearly 150 rum distilleries and almost 70 furniture makers. The great majority of these firms are small, family-owned businesses, use antiquated technologies and management techniques, and typically have little likelihood to emerge as exporters.

5.20 Among the major industrial firms in the country, the government generally holds some ownership interest. The Ministry of Planning and Cooperation[4] reported that industrial employment was 2,964 jobs in 1988. State industries accounted for over half of this employment. In regards to government involvement, one unsettling comment made to the team was that during the formation of SITA, a paint manufacturer, the government requested a 49 percent ownership share of the company. After protests from the private investors, the government eventually settled for 20 percent ownership. The founding of a new company requires contributions from the partners above and beyond mere subscription of capital. Government willingness to pay in capital, does not necessarily make the government a good investment partner, and the "passive" investment of money in a new enterprise can dilute the returns to "active" entrepreneurial investors. In line with the government's announced intentions to begin privatizing certain of its holdings, this type of coerced investment should be immediately terminated and these government holding sold to the original investors at the lower of cost or market price.

5.21 A useful commentary on the relative efficiency of government owned/run enterprises versus private ones is provided by comparison of ENACOL and Shell Cabo Verde (both firms import and distribute petroleum products and are classified in the tertiary sector). Shell Cabo Verde reportedly has 75 employees and accounts for 70 percent of the market in the country, while ENACOL, with 125 employees accounts for only 30 percent of the market.

5.22 According to the Ministry of Planning and Cooperation study noted above, CABNAVE was responsible for 88.2 percent of the industrial exports of Cape Verde in 1988. While there may be some question about this figure (it appears that processed/canned fish was not included in the figure for industrial exports), the basic point remains that this sector is so small in Cape Verde that the actions of a single firm are significant.

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4 Relatorio as Governo sobre a execucao do II Plano Nacional de Desenvolvimento, Ministerio do Plano e da Cooperacao, Dec. 1989, pp 113-119.

5.23 Among the firms interviewed, only SOCAL fits the generalized category of export oriented, free zone companies.[5] Originally founded as a government funded import substitution enterprise in the early 1980s, the government recently sold its participation to a private Portuguese firm. The European involvement provides a direct connection to markets outside the country: exports have been made to Portugal, the United States, England and Holland.

5.24 SOCAL is viewed by its Portuguese parent firm as a cost-effective offshore manufacturing location. They report that productivity in the plant is 70-75 percent of that in the parent's Portuguese plants, but that labor costs are 60 percent lower. While this wage differential is not as large as that between, for example, the United States and the Dominican Republic, it appears sufficient to offset the transportation costs and other factor costs which are more higher in Cape Verde than Portugal. After a slow period of business for the past six months, SOCAL plans to add another 25 workers to its existing labor force of 85. The potential noted by SOCAL gives grounds for cautious optimism that other export oriented industrial enterprises can succeed within Cape Verde and make a noticeable difference to the economic climate.

5.25 Nonetheless, the existing industrial base, due to its extremely small size and with the few exceptions noted above a lack of export competitiveness, provides limited potential for expansion under a free zone program. It is widely acknowledged by members of government and the private sector that the Cape Verdean private sector is neither large nor dynamic. It is likely that the potential for establishing export manufacturing operations will come from outside the existing industrial sector in Cape Verde. The factors which fundamentally will influence the country's ability to attract new investment are discussed below.

B. EVALUATION OF THE BASIC FACTORS OF PRODUCTION

5.26 The following section provides an evaluation of Cape Verde's basic economic factors of production as they affect potential export manufacturing operations which can be expected to be attracted to the country under a free zone program. This discussion is intended to relate to the country as a whole; however it focuses on Praia, Mindelo, and Sal which are the most probable locations. Where relevant, differences among these alternative locations within Cape Verde are also mentioned.

1. Labor

5.27 Labor Policy. Businesses in Cape Verde generally complained that they are hampered by the existing Labor Code. According to both employers and government officials, the Labor Code lacks the flexibility required for businesses to operate at their highest possible efficiency. A crucial aspect regarding labor is the difficulty in terminating the contracts of non-productive

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5 INFARMA expects to export approximately 50 percent of production while Confeccioes Morabeza expects to export 30 percent of its production this year.

employees. While a few firms contacted stated that this procedure is not difficult, many firms noted that the process is overly long, bureaucratic, and biased in favor of employees. Most interview respondents noted that this is particularly true after employees have worked for four years or more and are working on an indefinite contract period. While workers can be fired for stealing, or regularly being drunk or absent, they cannot be fired for overall poor performance.

5.28 The time needed to terminate an employee's contract varied widely depending on the source and ranged anywhere from 45 days to 2 years. The Department of Labor, which claims the process is relatively simple and straightforward, is presently studying the possibility of improving the tribunal process. At present, it must be noted that the perception by both employers and some government officials is that the tribunal process is unfairly weighted in favor of the employees. These difficulties are to some degree responsible for the widespread use of temporary workers, who do not receive severance pay or the same level of benefits as full-time contract employees.

5.29 On the positive side, the Labor Code has no minimum wage clause and apparently does make provision for the laying-off of workers given a drop in production. Moreover, the Department of Labor is solely responsible for the authorization of expatriate work permits, a reportedly simple and unbureaucratic process that requires only that the worker present a copy of the contract to the department. Finally, the Labor Code allows for payment to workers on a piece-work basis, although the concept is still not widely used in Cape Verde.

5.30 There is discussion within the GOCV that the Labor Code will be revised to ease the present rigidities. However, some observers have expressed the opinion that it will be difficult to improve substantially upon the present document. As a result, some analysts have noted that it may be easier to modify the industrial statute and exempt qualifying firms from these difficulties.

5.31 Availability. According to the Department of Labor, Cape Verde has a labor force of 107,000 people, with an unemployment rate of 25 percent. The labor force is segmented as follows:

80,000 employed
- 40,000 temporary contract laborers
- 32,500 permanently employed
- 7,500 indeterminate status

27,000 unemployed
- 22,700 looking for first job
- 4,300 previously employed

5.32 The unemployment rate in Praia approximates the national average while Mindelo has a slightly higher level at 28 percent. Unemployment is most prevalent among the younger members of the workforce as the unemployment rate for those aged 19-25 is 40 percent.

Population growth is greatest in the two urban areas and it is forecast that by the year 2000 Praia will have 110,000 inhabitants (presently 75,000) while Mindelo's population will increase to 70,000 (presently 45,000).

5.33 Interviews with Cape Verdean businesses confirmed that it is easy to find non-qualified workers, but there are shortages of skilled employees, technicians, and management level personnel. Consequently, most companies have instituted their own training programs. At present, Cape Verde's sole training institute is located in Mindelo but the new government plans to establish a similar institution in Praia in the near future.

5.34 Productivity. Assessments of Cape Verdean productivity varied but in general were favorable. Productivity was reported to be higher in Mindelo and Sal than in Praia; SOCAL's management estimated productivity at 70-75 percent of Portuguese levels. Studies of MORABEZA have found productivity levels 65-83 percent of Portuguese levels. SOCAL management reported that workers are typically trained in only 1-2 weeks, which is superior to their experience in rural Portugal. SOCAL, which was the only company contacted presently utilizing a night shift, noted no difference in shift productivity levels.

5.35 A number of managers have found that Cape Verdean workers respond well to bonus or other incentive schemes for increasing productivity, quality standards, or reducing absenteeism levels. One manager noted that a bonus plan increased productivity by more than 10 percent, while another manager stated that an incentive to reduce absenteeism rates had decreased daily absences from 13-14 percent to 6-7 percent. Other observers noted that some of the country's most productive workers -- who unload bagged cargo for EMPA -- work on a purely piecework basis.

5.36 Turnover rates and absenteeism levels were generally considered insignificant at less than five percent respectively. There were some reports that turnover and absenteeism rates are somewhat higher on Sao Tiago during peak agricultural periods, but this pattern was not confirmed in interviews with industrial firms.

5.37 Unions in Cape Verde have historically been relatively weak and only a small percentage of workers are unionized. Strikes, though legal, are uncommon, and labor-management relations are generally characterized as good.

5.38 Wage Rates. The cost and productivity of labor is the prime locational factor for IFZ industries. Salaries and wages typically comprise up to 80 percent of local operating expenses. Because of the wide range of wages paid to unskilled and semi-skilled workers in Cape Verde (CVE3,250-20,000/month) and the lack of a minimum wage, an assessment of Cape Verde's labor rates is difficult. It is reported that 25,000 Cape Verdeans work at a rate of CVE150/day on public works projects, and that there is strong pressure by the unemployed to create additional jobs in this sector. However, a number of sources have stated that these jobs give the workers much flexibility to follow other pursuits. As a result, these jobs have sometimes been preferred to jobs paying CVE250/day which require a full day's work.

5.39 High-level GOCV sources have confirmed that in the medium-term a minimum wage for the private sector will be established. The minimum monthly government pay -- for street sweepers et al -- is CVE8,000/month, although the minimum for the private sector will be substantially less. Wage rates in Praia and Mindelo are equal, while workers in Sal typically receive 30 percent more due to higher costs of living. Overtime work is subject to a 50 percent premium, as is common throughout the world.

5.40 Male day laborers in Praia receive CVE250/day while female day laborers receive CVE200/day. A construction firm paying this wage noted that it is not difficult to obtain workers. Nonetheless, numerous sources have indicated that a starting wage for industrial workers would need to be above CVE6,000/month. SOCAL -- an operation that is typical of IFZ firms -- uses a starting salary of CVE 6,800/month.

5.41 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 Cape Verde, the typical fringe benefit ratio for industrial firms is a relatively high 41 percent, while the statutory fringe benefit ratio is generally 31 percent.[6] This higher figure includes social security, accident insurance, one month vacation (in many IFZ countries, two weeks vacation is the norm), holidays, and a 13th month bonus.

TABLE 5-4
FRINGE BENEFIT RATES

Country	Rate
Dominican Republic	32%
Cameroon	35%
Honduras	35%
Togo	35%
Guatemala	37%
Mauritius	40%
Cape Verde	**41%**
Costa Rica	49%

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

6 It should be noted that fringe benefit ratios are generally equal between Mindelo and Praia; however in Sal, skilled workers often get housing subsidies which raise costs to employers by an additional CVE5-15,000/month per skilled employee.

5.42 Combining a base pay of CVE6,800/month with the 41 percent fringe benefit rate yields an all-inclusive prevailing wage of US$0.69/hour. This hourly comparison is calculated using a 45 hour week, and thus incorporates the advantage of an extra 5 hours per week over many other countries. Using a 31 percent fringe benefit ratio (by eliminating the non-statutory 13th month bonus and a week of vacation), a prevailing wage rate of US$0.64/hour is obtained. As can be seen in the Table 5-5, these wage rates -- though not the lowest in the world -- are in the same range of wage rates as found in Mauritius, Haiti, and the Dominican Republic. Nevertheless, at this rate, Cape Verdean labor is less expensive than that found in Costa Rica, Jamaica, and Cameroon.

TABLE 5-5
PREVAILING WAGES

Country	Hourly Rate
Indonesia	US$0.25
Kenya	US$0.26
Guatemala	US$0.35
Honduras	US$0.48
Togo	US$0.60
Dominican Republic	US$0.65
Cape Verde	**US$0.69**
Mauritius	US$0.70
Haiti	US$0.75
Jamaica	US$0.88
Malaysia	US$1.00
Costa Rica	US$1.08
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

5.43 A number of firms were interviewed in Cape Verde 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

5.44 Electricity in Cape Verde is produced and distributed by ELECTRA. Opinions on the quality of electricity service are generally favorable although some parts of Mindelo and Praia are subject to voltage fluctuation of as high as 15 percent. With one exception, interview respondents noted that blackouts are rare and that back-up generators are not a standard piece of equipment for industries. One firm in Praia did state that 30 percent of last year's production time required the use of a back-up unit, although it has been needed only five percent of the time this year. Other sources experienced significantly less difficulty with service. Electric hook-up is reportedly done quickly, generally within one week if a line is nearby.

5.45 Virtually all electricity generation is done by diesel generators. Praia, Mindelo, and Sal are all said to have adequate capacity for both the short- and medium-term. In Praia, ELECTRA is in the process of installing two new generators of 3 MW each, while maximum demand at present is only 3.3 MW. In addition to these two new generators, there are two older generators with a combined capacity of 4.2 MW. With annual demand for electricity in Praia growing at an annual rate of 10 percent, ELECTRA officials believe that Praia should have sufficient capacity through 1995-96.

5.46 Mindelo's electricity is produced by two generators with a combined capacity of 4.4 MW plus two old secondary generators of 1 MW each. In addition, there is 300 kw capacity from wind generation. Currently, peak usage in Mindelo is 3.4 MW. ELECTRA will be installing a mobile generator this summer to reinforce capacity. Demand for electricity is growing at an annual pace of 5-6 percent and ELECTRA officials believe that supply should be sufficient given that two new engines of 3 MW each will be installed in 1993.

5.47 The island of Sal has a maximum demand of 1 MW and presently has adequate capacity with a 1 MW generator, two 500 kw generators, and two 250 kw engines. Furthermore, another 1 MW generator will soon be installed.

5.48 The cost of electricity in Cape Verde for industrial users is calculated using a six-part formula and is therefore different for every enterprise. SOCAL reports that its electricity costs are CVE14/kwh or US$0.19/kwh. This rate is extremely high. Industrial electricity rates generally range between US$0.05-.10/kwh, with some countries -- such as Kenya -- offering rates as low as US$0.03/kwh. A general rule of thumb is that a large diesel generator produces electricity at US$0.09/kwh, this figure indicates that, even after the costs of distribution, taxes, etc., that there may be inefficiencies in production. In fact, one large consumer of electricity is contemplating the installation of a private generator for full-time use, given the potential cost savings.

TABLE 5-6
INDUSTRIAL ELECTRICITY RATES
(per kwh)

Country	Rate
Costa Rica	US$0.03
Kenya	US$0.03
Cameroon	US$0.05
El Salvador	US$0.05
Sri Lanka	US$0.07
Malaysia	US$0.07
Thailand	US$0.07
Taiwan	US$0.09
Honduras	US$0.10
Mauritius	US$0.10
Dominican Republic	US$0.16
Togo	US$0.16
Cape Verde	**US$0.19**
Senegal	US$0.25

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

b. Water

5.49 Water for Sal and Mindelo is the responsibility of ELECTRA while water in Praia is handled by CAAP. Mindelo and Sal utilize desalinization plants while Praia relies on groundwater. The supply of water continues to be a severe problem but both Praia and Mindelo are presently undertaking projects which should significantly improve the supply of water in the next two years.

5.50 Mindelo, which is entirely dependent on desalinated water, has a plant with a daily capacity of 1800-1900 m3/day. Demand is estimated at 3000 m3/day. To help ease this differential, ELECTRA is installing an emergency unit of 500 m3/day. In 1993, Mindelo will have an additional US$10 million facility with a capacity of 2400 m3/day set up. In the meantime, industries as well as residences receive water only one day a week, as a result, industrial firms are forced to construct water tanks.

5.51 Sal's water is provided by a new plant with a capacity of 500 m3/day; this amount covers current demand but has no excess capacity. The U.S.-financed plant -- with a capacity of 200 m3/day-- is used as a reserve.

5.52 Praia presently has a supply of 2100 m3/day with demand estimated at 3000 m3/day. In Praia, the many industries that receive water only in the morning have constructed water tanks to reserve water for afternoon use. ELECTRA is studying the possibility of establishing a desalinization plant in Praia. Within the next two years, CAAP will be accessing an additional 1500 m3/day from groundwater sources. For all three locations, if a water line is in the vicinity, connection is usually done within 1-4 weeks of the request.

5.53 The production cost for desalinated water -- which includes capital and energy costs but excludes distribution costs -- is CVE180/m3. In contrast, the production cost for groundwater is CVE40/m3. Regardless of location, the rate for industrial consumers is set at CVE160/m3 (US$2.19). This rate is the most expensive offered in any IFZ country. It is more than eight times more expensive that of Kenya's (US$0.27/m3) and three times higher than the cost in Togo (US$0.67/m3).

TABLE 5-7
WATER RATES
(per cubic meter)

Country	Rate
Guatemala	US$0.20
Thailand	US$0.21
Dominican Republic	US$0.25
Kenya	US$0.27
El Salvador	US$0.32
Malaysia	US$0.52
Togo	US$0.67
Cameroon	US$0.73
Costa Rica	US$0.79
Jamaica	US$0.79
Senegal	US$2.10
Cape Verde	**US$2.19**

Source: Data compiled by The Services Group from various sources

5.54 Nonetheless, it should be pointed out that in typical IFZ industrial sectors -- apparel and footwear -- water is not part of the production process and is therefore used only for sanitary and drinking purposes. Consequently, water costs generally comprise only a minute portion of total operating costs.

5.55 In terms of sewerage, a treatment plant exists in Mindelo and a sanitary plan for Sao Vicente is now being conducted. In Sal, only septic tanks are presently in use although a treatment plant will probably be constructed in the next five years. A treatment plant is used for the downtown area of Praia but most of the city continues to rely upon septic tanks.

c. Telecommunications

5.56 Telecommunications (as well as the mail and a soon to be established express mail service) is handled by the CTT. The quality of domestic phone service was felt to be passable and reportedly equal throughout the country.

5.57 International service (which is coordinated through a switching center in Praia) was reported to be problematic at times with different degrees of difficulty depending on destination. Service to the United States was judged to be among the best international service with calls generally completed on the first few dial attempts. Service to Europe (in particular, Portugal) was reportedly more difficult, requiring as many as 5 to 10 attempts before calls could be completed. Service to West Africa was reported to be even more difficult. Line quality of calls to the United States was usually fairly clear, although data (modem) transmission would still have difficulties. Given the anecdotal nature of this evidence it is hard to draw conclusions. The differential success in calling can in many cases be assigned to failures of the correspondent phone company in the foreign country (e.g., in Portugal and West Africa).

5.58 At present, there does seem to be a lack of international line capacity. International service is presently provided over a submarine cable and an INTELSAT Standard B satellite earth station. The cable, which carries only five lines to Portugal, is due to go out of service in 1993. The earth station currently handles 28 circuits, but is being refitted with better electronics to increase its capacity to 58 circuits by the end of this year and potentially more in the future (see Table 5-8). There are studies being undertaken to assess the need for increased capacity in the future, including a Standard A satellite earth station.

5.59 According to the CTT, demand requires that the number of international circuits be doubled or tripled, particularly given the termination of the use of the submarine cable to Portugal in 1993. At the present time, Cape Verde has direct dialling capability to six countries: Portugal, the United States, France, Holland, Senegal, and Angola, with direct links to Italy to be established later this year. The lack of direct lines to West Africa must be seen as a considerable constraint for any businesses attempting to export or re-export goods to the continent.

5.60 Delays for the hook-up of new phones varies anywhere from two weeks to a year. Officials at the CTT note that industrial firms get first priority of available lines. Nonetheless, there is a long waiting list to get a telephone as the number of lines available is dwindling. Local line and switching capacity appears to be the most serious near-term constraint. The situation is worst in Praia where the switching center has capacity for only 103 lines additional

lines; based on the number of new subscribers last year, these should be exhausted within a six-week period. There is a one year lead time from the manufacturer on equipment to expand the switching center capacity. Local line capacity is better in Mindelo and Sal, with 1,000 and 400 lines available, respectively.

TABLE 5-8
INTERNATIONAL TELECOMMUNICATIONS CIRCUIT PLAN

Country	1991	1992	1995
Portugal	35	44	68
United States	6	30	60
Italy	4	4	30
France	3	20	28
Holland	2	10	20
Senegal	2	5	7
Angola	1	2	3
Spain	0	6	9
TOTALS	53	121	225

Source: CTT.

5.61 Telecommunications costs to Portugal are CVE140/minute (US$1.92/minute). This tariff is relatively uncompetitive, as corresponding rates from Mauritius and Kenya to Europe, for example, are in the range of US$1.60-1.69/minute. In recognition that the tariff to phoning the United States was overly high, the CTT recently dropped the price from CVE300/minute to CVE240/minute.

TABLE 5-9
TELEPHONE RATES TO MAJOR TRADING PARTNERS
(per minute)

Country	Rate
Dominican Republic (to the US)	US$1.05
Honduras (to the US)	US$1.05
Guatemala (to the US)	US$1.06
Costa Rica (to the US)	US$1.25
Malaysia (to the US)	US$1.48
Thailand (to the US)	US$1.48
Mauritius (to France)	US$1.60
Kenya (to the UK)	US$1.69
Cape Verde (to Portugal)	**US$1.92**
Togo (to France)	US$2.68
Senegal (to France)	US$3.42
Taiwan (to the US)	US$3.95
Cameroon (to France)	US$4.35

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

d. Land/Factory Construction

5.62 Land in Cape Verde is distributed by the municipalities under 40-year leases with a 20-year extension period possible. Lease rates for industrial land are extremely inexpensive at CVE10-20/sq.m./year. However, the process for obtaining land leases is sometimes difficult, requiring anywhere from one month to one year in delays for industrial concerns and longer for residences. In addition, there are no criteria for allocating land, and the process can sometimes be subject to favoritism.

5.63 Under the new government, power is being decentralized to the municipalities and it is expected that land will eventually become available for purchase by both local and external investors. While these purchase prices have not yet been determined, the municipality of Praia is considering a proposal that would classify land at prices ranging from CVE1,500-23,000. This proposal, if accepted, would clearly make land prices in Cape Verde uncompetitive, and remove one of the country's few comparative cost advantages. In contrast, the municipality of Mindelo will probably sell land at prices approximating the present value of the standard 60-year lease.

5.64 In terms of land policy, the issue is not that land cannot be purchased (as 60-year lease terms are generally sufficient for investors) but that land cannot be sub-leased. The present

policy allows for the sub-lease of buildings but not land. It is fairly common in IFZ/industrial estates for the developer/operator of the zone to lease land to tenants who then construct their own facilities. At present, this arrangement would be illegal in Cape Verde.

5.65 Construction of 1,000 sq.m. standard factory building (SFB) is estimated at approximately CVE17,000-19,000/sq.m. (US$233-260/sq.m.). Mindelo would be on the lower end of this scale while Praia and Sal would be on the higher end. This cost is on the high end of the scale: SFB construction costs in other IFZ countries generally range between US$120-170/sq.m. It should be noted that an IFZ developer/firm would be eligible to import all construction materials duty-free, thus allowing for a reduction in costs of 10-15 percent. Factory construction cost is an important factor in IFZ development, as it is the principal determinant of the lease rate which is required for cost recovery and/or profitability. At the present time, it should be pointed out, the concept of renting SFB space is not widely practiced. The only example found was the leasing of a former military hangar on Sal to a hotel supply firm.

TABLE 5-10
CONSTRUCTION COSTS
(per sq.m.)

Country	Cost
Guatemala	US$100
Dominican Republic	US$106
Sri Lanka	US$120
Mauritius	US$131
Costa Rica	US$135
Malaysia	US$150
Thailand	US$152
El Salvador	US$170
Kenya	US$172
Togo	US$175
Cape Verde	**US$233**
Cameroon	US$275

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

3. Transportation

a. Ocean/Surface Freight

5.66 Transportation. At the present time, Cape Verde's transportation network presents the greatest challenge to a successful IFZ program. Sea freight rates -- at approximately US$1,900 per 20 foot container to or from Europe -- are relatively expensive. At this tariff, the cost of sea freight from Cape Verde is nearly double that of Togo's (US$1,130) and more expensive that found in Kenya (US$1,650). These rates are nearly equal to those for IFZ industries in Mauritius, which receive a 25 percent subsidy on general rates.

5.67 An additional constraint posed by sea freight for Cape Verde is the irregularity of service. There are five lines that provide regular service (every 30-45 days) to Europe, as part of different routes which include other African ports. This scheduled service includes three container ships. On balance, this translates to only 2-3 ships per month to Europe. In contrast, Mauritius is served by nine ships a month while major IFZ countries close to the U.S., such as Costa Rica and the Dominican Republic have virtually daily service. Although there is normally service to Europe from Cape Verde every 7-10 days, shipping schedules are uncoordinated and shipments are sometimes not possible for 2-3 weeks.

5.68 To North America the situation is even more difficult, as direct service is provided by one ship and operates at best only every 45 days, typically only every 60-90 days depending on the amount of cargo. Moreover, the ship is not well suited for containerized cargo. The estimated cost for shipping a container to the United States is also not very competitive versus Caribbean Basin countries at the US$2500 per 20 foot container charged to MORABEZA. Traffic also exists to West Africa but is subject to the same irregularities and high costs. The management at INFARMA noted that the cost of transportation comprised 70 percent of the cost of one export shipment of pharmaceuticals to Angola.

5.69 The importance of regular shipping schedules is that many subcontracting arrangements have strict delivery requirements and allow for non-payment or penalties for late shipments. As a result, firms such as SOCAL and Morabeza have often been forced to utilize air freight, which is much more expensive. SOCAL once had to refuse an order for 30,000 pairs of shoes for lack of transport.

5.70 The two principal ports in Cape Verde -- Mindelo and Praia -- are not particularly well configured for container handling, which is the predominant mode of transport for IFZ industries. Less than 10 percent of incoming ocean freight is containerized. Neither port has a specialized container crane and container handling costs can be high. In Praia, despite the World Bank project, the limited capacity of the port's 12 ton crane is typically insufficient for container handling, as full containers typically weigh 20 tons. However, most ships serving Africa have their own crane and are able to skirt this problem. Each port has only one forklift suitable for transporting containers. Because handling costs are charged by the hour, rather than by the ton, costs are higher and the port is considered relatively slow by international standards. ENAPOR

officials noted that it sometimes takes up to one hour to unload a container, although the average is 8-9 containers per hour. While this rate is similar to that in other West African ports, on a global basis levels of 30 containers per hour are regularly achieved. Moreover, both ports lack storage space area, in Mindelo, for example, there is storage space for only 100 containers.

5.71 The port of Praia is often hampered in the July-September season by high waves. Consequently, ships sometimes have to wait 5-6 days before they can be unloaded safely. Because of the possible danger to the ship and the cargo, some ships refuse to call on Praia during this season. Other than this, there are few delays in getting a berth in either Praia or Mindelo.

5.72 Despite these container problems, it should be underlined that Cape Verde's two ports are among the best managed in West Africa; they are clean, safe, well-run, and suffer from virtually no pilferage.[7] Mindelo, with a draught of 11 meters, is one of the deepest ports in West Africa. Handling costs, other than for containers, are competitive with other West African ports. Compared to Dakar for example, Mindelo's costs are 20-30 percent less, and productivity in terms of tons handled per hour is 50-100 percent higher according to ENAPOR officials. The port of Mindelo can operate on a 24-hour basis and through CABNAVE, offers the advantage of ship repair facilities. The port of Mindelo has a grain silo as well as some bagging capabilities. Depending on the criteria used, the port of Mindelo is operating at only 15-50 percent of capacity and thus has the capability of handling more traffic given additional investment in equipment and infrastructure.

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7 It should be noted that pilferage is a problem on Cape Verde's internal sea traffic.

TABLE 5-11
SEA FREIGHT RATES
(US$ per 20-foot container)

Country	Rate
Honduras (to US)	US$1005
Dominican Rep. (to US)	US$1010
Guatemala (to US)	US$1040
Costa Rica (to US)	US$1115
Togo (to Europe)	US$1130
Taiwan (to US)	US$1300
Cameroon (to Europe)	US$1562
Kenya (to Europe)	US$1650
Cape Verde (to Europe)	**US$1900**
Hong Kong (to Europe)	US$2127
Mauritius (to Europe)	US$2500
Malaysia (to US)	US$2735
Thailand (to US)	US$2735

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

c. Air Freight

5.73 Air freight from Cape Verde to Europe is expensive, compared to other IFZ countries and regional standards. Air freight from Sal to Portugal is approximately US$0.90/kg, a competitive rate compared to that found in other African countries. However, shipping from Mindelo or Praia to Sal doubles the cost, giving a less competitive rate of US$1.90/kg. By comparison, air freight from Togo to Europe is US$1.56/kg while shipments from Mauritius are US$1.72/kg. In the past, shipments from Mindelo to Boston cost US$2.20/kg.

5.74 Cape Verde does not offer frequent air connections compared to other countries hosting IFZ programs. Nations in the Caribbean Basin generally have multiple flights per day to the United States while Togo has one flight per day to Europe. In contrast, Cape Verde has two flights a week to Portugal (increasing to three in the busier summer and Christmas seasons), weekly flights to France and Germany, and only 18 direct flights per annum to the United States (service is available only six months of the year). Service is available to Dakar three times per week while there are one to two flights weekly to Guinea-Bissau.

5.75 According to officials at TAP, substantial excess cargo capacity exists at present on outgoing flights. TAP's plane serving Cape Verde can carry 15 tons of cargo per flight,

however, in 1990, only 50 tons total were exported. Incoming flights typically had 8-10 tons of air cargo. TACV officials noted that additional space for air freight is a serious problem on incoming flights from Senegal and the United States as both are typically at capacity. However, room is available for Cape Verdean exports on these flights.

5.76 The real problem with air freight is not just the cost, but the difficulty in service from either Mindelo or Praia. Because the planes utilized for domestic air traffic are small and not well configured for air freight, it is extremely difficult for exporters to rely on this service. Domestic TACV flights can carry only 500 kilograms of cargo, including passenger baggage. Internal TACV problems have greatly aggravated the situation. An inability to maintain published schedules, cancellation of flights for no apparent reason, special treatment of passengers using certain travel agents, and ponderous bureaucracy have exacerbated the difficulties. For an airline with four planes and 600 workers, the level of service could be expected to be adequate, but in reality the level of service is extremely low. The government realizes this and has stated in its program that it "urgently understands that [TACV's] reorganization and rationalization should be undertaken to improve its operation and financial situation."

5.77 Reliable and efficient air passenger service is also an important factor for foreign investors in assessing an overseas location. Here the constraints of air cargo service also plague routine passenger traffic. An encouraging sign is that TAP management is planning to improve current service levels at Sal through the establishment of a business class, business class check-in lines, a VIP lounge, and through-checking of bags. These changes, if implemented, would allow Cape Verde to make a more favorable impression on potential investors.

5.78 Cape Verde, due to its geography as a remote island archipelago, relies critically on both passenger and cargo service by air. The government and donor community recognizes the need for drastic reorganization of TACV with a corresponding improvement in management and service. An important component of this restructuring is the fundamental purpose and orientation of TACV: i.e. whether it is a public service to be guaranteed by the financial support of the government and run as such, or whether it is properly a commercial enterprise. Until an improvement in TACV services is accomplished, the ability to attract overseas investors will be limited.

5.79 In addition to the restructuring of TACV, there are two other items that may significantly improve Cape Verde's air transportation services. First, with the lifting of U.S. sanctions against South Africa, it is expected that flights between South Africa and the United States via Cape Verde will resume shortly. As a result, Cape Verde would once again have regular direct access to the United States.

5.80 Second, it is expected that the construction of the new airport at Praia (for which the earthwork has already commenced) will be completed by November 1994. This facility will include a 2200 meter runway which is sufficient for an Airbus or 737 aircraft. Because 65 percent of TAP's passengers are destined for Praia, TAP management has said that it will begin

flying to both Sal and Praia. Besides easing the burdens of passengers, it will reduce by approximately 50 percent -- or the same level as now exists from Sal -- freight costs for companies in Praia. Moreover, because the shipments will not have to be placed on smaller TACV connecting flights, cargo handling and packaging should be made easier.

TABLE 5-12
AIR FREIGHT RATES
(per kg.)

Country	Rate
Honduras (US)	US$1.03
Guatemala (US)	US$1.06
Dominican Republic (US)	US$1.10
Costa Rica (US)	US$1.24
Togo (France)	US$1.56
Mauritius (Europe)	US$1.72
Cape Verde (Portugal)	**US$1.90**
Senegal (France)	US$2.50
Sri Lanka (UK)	US$2.90
Cameroon (France)	US$2.98

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

4. Capital

a. Capital Requirements of IFZ Firms

5.81 The financing requirements of export firms vary greatly according to the nature of the industrial operation. While heavy industrial operations have large fixed asset financing requirements, most light manufacturing operations have less substantial funding needs. For typical IFZ light manufacturing firms which are affiliates of foreign 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 or contracting company.

5.82 Nonetheless, the financing requirements of exporting firms, particularly domestically-owned, can be significant by Cape Verdean standards. 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;

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

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

5.83 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. Cape Verde's Financial Sector

5.84 Since independence, the Bank of Cape Verde has had a monopoly on banking activity in the country, serving as Central Bank, commercial bank and development bank. As part of the liberalization of the economy, initiated under the previous administration and continuing under the present, the financial sector is being deregulated. The Bank is scheduled to be divided into a Central Bank, responsible for monetary policy and a commercial/development bank, which will operate in the market.

5.85 Foreign-owned firms typically have access to external sources for finance. For these companies access to local financial markets can be an added incentive, however, the availability and cost of capital is a critical factor for local investors. Currently, the Bank of Cape Verde (BCV) offers long-term loans of 12.5 percent with grace periods of 1-3 years. The BCV will finance up to 67 percent of a project. Investors have reported that the bank is ineffective as a commercial bank as it is slow and cumbersome. Requests for working capital are often only approved after a firm's cash flow problem has already been solved. In addition, the bank does not offer lines of credit. Delays in receiving letters of credit have also been a problem according to some firms, as has the cost of this service. With the legalization of private banking, it is expected that the establishment of competing private commercial banks will ease these constraints. According to officials at the Bank of Cape Verde, there are already advanced discussions with three Portuguese banks, one American and one additional European bank.

5. Other Factors

5.86 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 pre-empt any appeal to foreign investors despite the country's economic resource endowment or the existence of an attractive package of incentives.

5.87 Cape Verde has a number of these non-quantifiable factors to its credit. While not exactly economic factors of production, political stability and quality of life are important to foreign investors. The recent political transition -- rare in Africa -- will be seen as a positive for investors, particularly if the new government can successfully implement the liberalization measures envisioned. The quality of life in Cape Verde is, in general, positive, and should also be considered an attraction to some investors.

5.88 Unfortunately, however, there are a number of negative factors which might outweigh these positive attributes in the eyes of foreign investors. Cape Verde is relatively weak in the provision of business services vis-a-vis competing countries. It was reported that only one accounting firm exists in Cape Verde for example, and the level of expertise in international commercial law was also said to be relatively poor. Moreover, service provision in terms of the repair of machinery and office equipment is lacking. The present state of Cape Verde's manufacturing sector will similarly require that nearly all material inputs (except for agro- and seafood-processing industries), including relatively simple items such as packaging, be imported. In terms of seafood-processed exports, Cape Verde lacks the testing equipment necessary for exportation to developed countries. Although the GOCV plans to liberalize the insurance sector, there is currently only one insurance company which reportedly charges high rates for freight insurance, thus further increasing the already high transportation costs. Lastly, complaints were heard from investors on the quality of health care available, an important issue for some foreign investors.

5.89 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.

6. Foreign Investor Interest

5.90 In the last three years, it is estimated by past and present Ministry of Industry officials that 200-300 foreign investors have visited Cape Verde. Despite this initial interest, there has been little concrete realization of foreign investment projects since the establishment of its Industrial Development Law and Statute in 1989. Cape Verde can point to only a handful of new investments over the past two years. These projects include a civil construction firm producing pre-fabricated buildings, a soap factory in Mindelo, a plastic materials factory in Mindelo, and a salt producer in Maio. Of these new investments, only the salt enterprise is designed to service external markets.

5.91 The reasons for this weak performance are numerous and many are evident in the above section outlining the difficulties regarding transportation, infrastructure, and factor costs. While foreign investors are willing to cope with some difficulties (the Dominican Republic's electric supply was virtually non-operational in the second half of 1990, for instance), other advantages must be able to compensate for these negative factors.

5.92 Significantly, past and present Ministry of Industry officials have expressed the belief that up to 20 additional firms would have invested in Cape Verde (primarily Mindelo) if ready-to-occupy SFBs were available. Given the lack of corroborative evidence that could be provided by these officials, this figure is probably overly optimistic.

5.93 In addition, other less quantifiable factors must be included. The past government, despite an outwardly welcoming hand to investors, was seen by some observers as remaining somewhat suspicious of both local and external investors. This argument is perhaps best evidenced by the slow movement to establish the implementing regulations for the four laws discussed above; only six of 13 regulations have been finalized after one and a half years.

5.94 According to officials at both the Department of Industry and PROMEX, more than half of all potential industrial investors to Cape Verde are Portuguese. These investors have tended to view Cape Verde as a good site for import-substitution activities as well as a jumping off point for Africa. To date, few Portuguese investors have envisaged Cape Verde as an offshore manufacturing center for the European market, although it is difficult to say whether this is more related to Portugal's relatively young industrial sector or to Cape Verdean constraints. One of PROMEX's tasks will be to convince Portuguese businesses -- who are seen as a low-cost manufacturing base for the EC -- that additional labor savings are available in Cape Verde. However, it should be pointed out that the differential between Portuguese and Cape Verdean (2-3 times) wages is much less than that existing between the United States and Caribbean Basin countries (5-15 times).

5.95 According to officials at PROMEX, there are now six serious existing industrial inquiries for export in the sectors of footwear (two), apparel (one), banana puree (one), and fish processing (two). All of these companies would serve Europe or North America. There has also been a high level of interest from various, mainly European groups, regarding the possibility of large-scale tourism projects. Tourism is outside the scope of the present investigation, but it is important to note that a major tourism project would necessitate improved air transport links.

5.96 The Ministry of Industry and Energy listed 23 companies as having expressed interest in investing in Cape Verde over the 1985-1990 time period.[8] Of these firms, fifteen were from Portugal, four from Sweden, two from the United States and one each from Brazil and Angola.

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8 As stated above, past and present Ministry of Industry and Energy officials claim that as many as 200-300 interested investors have visited Cape Verde over the past two years. However, the only written list of potential investors was that which appeared in the Achada Grande Site Survey (March 1991, Tecno Consult, Annex 8). The twenty-three investors listed there are apparently a qualified group of serious investors.

Out of this number, two have already made investments (both Portuguese firms) and two additional firms (one Portuguese and one Brazilian) are continuing to pursue projects.

5.97 The committed investments include the Saboes de Cabo Verde soap factory which is being constructed in the Ribeira de Juliao industrial zone on Sao Vicente and the second is a plastic packaging manufacturer also installing in Mindelo. The continuing interest comes from a Brazilian firm looking to extract salt and from a Portuguese firm interested in investing in construction.

5.98 To date, interested investors have been handled on a reactive basis -- no active solicitation has occurred. Unfortunately, these contacts have not been tracked systematically by either the UPI/IPI, the Ministry of Industry or PROMEX. It is expected that PROMEX will begin a tracking system shortly. From this limited investor interest to date, some limited conclusions can be drawn regarding the likely origin of foreign investors. First, the Lusophone connection is an important one. The strong response from Portuguese firms and expressions of interest from Brazil, Angola and Macao point to these countries as likely sources for investment and markets. Second, the next most important connection would be Western Europe. The strong interest from Swedish firms and the existence of relatively good sea freight connections to Europe make this the next most likely source for investment and markets.

C. RELATIVE IMPORTANCE OF FACTORS CONTRIBUTING TO IFZ SUCCESS AND FAILURE

5.99 Although it is impossible to quantify the various factors behind an IFZ's success, a number of generalizations can be made, in terms of both macro and micro issues. On a national level, the cost of labor remains a critical factor in the site selection process, particularly for extremely cost-competitive, labor-intensive industries such as the apparel sector. In this sector the value-added is essentially limited to the cost of labor and services unless local textiles are used; labor costs comprise as much as 80 percent of local operating costs. Conversely, the importance of subsidized rental rates, although still attractive to some investors, pales in comparison as rental costs typically comprise only 3-5 percent of total costs. Similarly, it should be emphasized that for most IFZ and CFZ firms, water and electricity comprise only a small percentage of total operating costs and, as such, the reliability of the service is much more important than cost.

5.100 In addition to concerns of labor cost, apparel firms are extremely cognizant of the quota situations for developed country markets. Owing to the importance of market access, some Asian firms have been forced to seek newer offshore manufacturing operations in order to expand, often farther from corporate headquarters than would be the case without quota limitations or barriers.

5.101 For more sophisticated industries, such as heavy manufacturing or pharmaceutical products, the educational level of the labor force, the cost of transportation, availability of local

raw materials, and the quality of available infrastructure and facilities assume greater importance than labor costs alone.

5.102 Despite their reputation as enclaves, IFZ programs cannot always be isolated from weaknesses in the surrounding economy. Severely overvalued currencies can stall development of a program, while infrastructure problems -- such as the Dominican Republic is presently experiencing with its electricity sector -- can severely limit investment. Political instability, despite the strength of other factors, can devastate a program.

5.103 In the final analysis, there is no one factor that can make an IFZ program successful. The fact that Senegal has revamped its legislative package is not likely to overcome the country's other constraints any more than the low labor costs of Burundi (US$0.30/hour) can mitigate that country's terrible transportation constraints. On the other hand, it is evident that a free zone program can be destroyed by a single factor, whether it be political instability, poorly formulated IFZ legislation, or an overzealous bureaucracy.

5.104 The proximity, quality, and cost of infrastructure, transportation, and labor are all 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. With the exception of the cost of land, there is no economic factor where Cape Verde has a clear comparative advantage. The country is relatively expensive in terms of water, electricity, construction, and transportation costs. The quality and reliability of infrastructure and transportation service also puts Cape Verde in a somewhat disadvantageous position. However, with pending improvements in these areas it is expected an adequate level of services for free zone activities will be possible.

5.105 The prevailing wage rate, though competitive, does not put Cape Verde in a leading position for this critical aspect. Moreover, questions remain about the productivity of Cape Verdean labor. Nonetheless, at this juncture, the cost of unskilled labor remains the most important attraction for future industrial investors.

5.106 On balance, and with some improvement in basic services, Cape Verde has the necessary attributes to attract what will probably be a limited number of firms in export manufacturing. It does not have any overwhelming advantage, or would have been more sought-after already as an investment site. Yet, nevertheless, with the proper measures and efforts at overcoming factor cost disadvantages, the country could be viable as an offshore manufacturing location. The physical facilities required, in the form of a geographically defined zone or industrial estate, and the development of appropriate policies, are the subject of the following chapters.

VI. OPTIONS FOR INDUSTRIAL ESTATE/INDUSTRIAL FREE ZONE DEVELOPMENT

6.01 As noted in Chapter II of this report, industrial free zone programs can be configured in a variety of ways. Many successful zone programs include options for both Single Factory Free Zones and geographically defined zones housing multiple firms, or the classic industrial estate/IFZ. There is little difference in the incentive or other operating conditions between the two modes. However, there are a number of advantages to clustering industrial development in a defined industrial estate which appear to make sense for Cape Verde. The lack of available factory space, relatively high construction costs, and deficiencies in infrastructure all suggest that a properly configured industrial estate/IFZ would be an effective means of addressing these current constraints. The simple lack of any ready industrial facilities has reportedly been a deterrent for a number of potential investors who have visited the country.

6.02 The Project Team examined a number of possible industrial estate sites in Mindelo, Praia, and Sal. Other islands were not investigated due to the extreme difficulties in transportation and/or infrastructure and small labor pools. The specific sites examined were those proposed or previously identified by either the municipalities or the Ministry of Public Works.

6.03 In general, it is recommended that an industrial estate site be at least 10 hectares in size, which will allow some economies of scale to the developer. The land should have a slight slope, though less than the 6-8 percent gradient at which earthwork costs become prohibitive. The land should not be particularly susceptible to drainage problems, earthquakes etc. To ensure a sufficient labor force, a population center of at least 20,000, and preferably more than 50,000, should be located within commuting distance. While close access to a port and airport are desirable, unless direct access to these facilities can be provided, the industrial estate does not necessarily have to be located in close vicinity to these facilities; trucking a container ten miles is not significantly more expensive than shipping it one mile -- the cost is primarily in the handling. With these general guidelines in mind, an evaluation of the proposed industrial zones can be undertaken.[1] The development of IFZ/industrial estates also requires specific financial and technical resources which may not be domestically available. The latter sections of this chapter address external financing sources and options for technical assistance.

A. SITE EVALUATIONS

1. Mindelo

6.04 **Zona Industrial Sul**, located on the western border of the road to the airport and adjacent to the horse track, is a site of under 2.0 ha. The area is already host to companies such

[1] More detailed industrial estate guidelines are presented in Annex B of this report.

as FAMA, SITA, and VICAVE. The ground seems to have undergone filling and compacting and provides a good base for SFB construction. The area was once subject to drainage problems but this problem has reportedly since been corrected. Very little space is available for construction and the residential neighborhood of Campin exists to the northeast. The zone is well served by roads and has sufficient electric and phone capacity for the time being.

6.05 **Ribeira de Juliao,** a second proposed zone, is located south of the Zona Industrial Sul, bounded by the Ribeira da Vinha road to the northwest and the Ribeiro de Juliao road to the northeast. A plan for an industrial estate was recently completed by the Ministry of Public Works and responsibility regarding future development of the site -- if any -- is with the municipality. The plan for the estate covers approximately 12 ha.; additional space south and southwest of the site is potentially available for future expansion. SABOES is constructing its factory within this area; in addition, located east of the area is ENAVI, a poultry company. A squatter settlement exists in the northeast portion of the proposed site, and to the south -- but outside the proposed area -- the provisional city dump of Mindelo can be found. The site is crossed by two channels and the channel to the northwest is reportedly subject to extremely severe flooding. Consequently, the plan has called for two embankments to reduce this risk. There is a 3-4 meter difference in height between the northern and southern extremes of the site. Vegetation is largely limited to acacias and palm trees. The soil is basaltic with a rocky base one meter under the surface; it is reportedly sound for SFB construction.

6.06 The master plan prepared has over 20 lots segmented into 5,000 sq.m. sections, with the average SFB being 1,500 sq.m. This plot coverage of 30 percent (5,000/1,500 sq.m.) is an acceptable ratio but could hinder financial returns on the zone; industrial estates typically feature plot coverage between 30-50 percent to assure a larger revenue base.

6.07 The site is seen by municipality officials as offering the best potential and is the easiest to connect to infrastructure. At present, there is sufficient electric capacity in the area and ELECTRA hopes to install an electric circuit devoted exclusively for industrial users in four years. A water line is currently being extended to the area and should be completed in the near future.

6.08 **Lazareto.** A third site that has only recently been identified by the municipality is the Lazareto industrial zone, just east of the village of Lazareto. The zone is located at the juncture of the airport road and the road to Morro Branco. The site is completely unoccupied at present, although the area bordering the sea is planned to be given to ENACOL for the construction of some storage tanks. To the east, adjacent to the airport road, is a line of acacia trees. Just west of the site is a steep graded mountain; the site in general is hilly with a gradient well above 8 percent on the southern portion of the site. The soil is sandy, but was reported by municipal authorities as sufficient for SFB construction. It should also be noted that the site affords an extremely scenic view over the city and bay of Mindelo, a feature which can be an attractive selling point. However, this position near the water also exposes the area to strong winds, which may not be a disadvantage except for certain types of industries.

6.09 The preliminary master plan is approximately 4 ha. in size and shows 25 SFBs with under-roof space of approximately 450-550 sq.m., each with a fairly generous 33 percent plot coverage. Based on the field visit, there is a great deal of expansion area south of the zone, although portions suffer from higher gradients than ideal. A six kv aerial line is nearby and has adequate capacity at present. However, no water line is currently in the vicinity.

6.10 Placement of an industrial estate on the flat ground parallel to the airport road somewhere between Galé and the airport was also discussed with municipal authorities, but the area is subject to severe flooding and can be covered with more than one meter of water during rainfalls.

2. Praia

6.11 **Achada Grande** is a zone east of the airport which has been zoned as an industrial area by the Ministry of Public Works and the municipality of Praia. North and northeast of the zone lie the communities of Achada Grande and Achada Grande de Tras which together comprise approximately 1,000 inhabitants. The zone is two kilometers from the port of Praia and is directly adjacent to the airport. The area features a slight slope and would require very little in terms of earthwork. A strong northeasterly wind predominates. There is virtually no vegetation and the basaltic soil appears to be excellent for SFB construction. In addition, the site offers a picturesque view of the sea and is near the beach of Portinho. The planned first phase of development is 8 ha.; substantial room for expansion of the zone exists.

6.12 A technical study financed by the European Community was completed in March of this year and the EC is to provide financing for the zone's infrastructure in its upcoming five-year plan. As presently configured, the first phase of the project will encompass eight ha. and the infrastructure cost will be US$1.05 million. The master plan consists of 45 industrial plots, with more than 50 percent of them under 1,000 sq.m. in size. In terms of IFZ industrial estates this is on the small side, as IFZ industries generally utilize SFBs of at least 1,000 sq.m. in size (a plot of 1,000 sq.m. could be expected to have SFBs of a maximum size of only 500 sq.m.). Twenty-nine percent of the plots are to be 1,000-3,000 sq.m. in size, with the remainder being above this level.

6.13 In terms of infrastructure, the airport is the only facility on the plateau to receive piped water and no water lines are available in the vicinity. Consequently, the plan calls for the construction of a 100 cubic meter storage tank which will be filled by autotank. Electricity in the area is not foreseen as a problem as a 15 kv, 50 mm line provides sufficient capacity. The zone plan requires the installation of 100 lines, which according to the CTT should not impose a problem, given that construction of the zone is not anticipated within the time frame that is necessary for the CTT to order and install additional local switching capacity on Sao Tiago. At present, the CTT plans to install a cable with 20-30 lines in the area to provide an additional 2-4 lines for the airport. The remaining lines will be available to others in the area and the cable is

expected to be completed in October of this year. The plan also takes advantage of its geographic position relative to the airport by providing for direct access.

6.14 While no market analysis, environmental impact, or economic rate of return analysis of the project has been conducted, the plan projects that the first phase of the zone will be filled within 5-8 years.

6.15 **Tira Chapeu.** A second industrial zone lying within the western portion of the Praia municipality is that of Tira Chapeu. The zone reportedly is four ha. at present with the ability to expand to nine ha. in size eventually. Substantial industrial activity already takes place in the area as evidenced by the presence of SITA, DOCI/PICA PAU, and EMPROFAC/INFARMA. However, the site suffers from extreme gradients and has thus increased the cost of construction to area firms substantially. The level of infrastructure in the area is considered minimal. The Ministry of Public Works has decided that in the future medium and large-scale industries will be allocated property on Achada Grande while the Tira Chapeu zone will serve as a base for artisanal and other small firms.

3. Sal

6.16 Although the Delegado for Sal was not able to provide a copy of Sal's industrial zone plan, an area of approximately 20 ha. is reserved for industrial activities between the airport and the port of Palmeira. Reportedly, the boundaries of the area are not well defined, but it is said to encompass land both north and south of the road to Palmeira. The southern portion of the site, which would have direct access to the airport, is fairly rugged terrain with portions above the eight percent slope level. To the north of the road, following a sharp ridge parallel to the road, is good, level terrain. In addition, as the land approaches the port, it levels out on both sides of the road and appears to be highly suitable for SFB construction. Situated between the port (where ELECTRA's electric and desalinization facilities are located) and the airport, the site would appear to be well placed for infrastructure provision.

4. Comparative Analysis

6.17 Mindelo, Praia, and Sal each have advantages and disadvantages as sites for an industrial estate. In the end, Sal ranks as the least favorable of the three choices. Despite the fact that Sal possesses the best air transport links and has good tourist facilities, it is hampered by the fact that labor costs are higher than elsewhere in the country. Regardless of the willingness of Cape Verdeans to move where job opportunities arise, it has been reported that hiring 100 workers for a factory would be difficult on Sal because of its small population. In addition, skilled labor is said to be even more scarce on Sal. There is a shortage of housing and by far the worst port of any of the three choices. Finally, experience in tourist areas of the Dominican Republic and Jamaica has shown that it is often difficult to retain workers in IFZ

firms when tourist related employment is available because of the more pleasant work surroundings and higher pay scales.

6.18 Praia's advantages include the largest labor supply, better water service than Mindelo's, and the construction of the new airport. Furthermore, the Achada Grande site is the best of those presently being considered in Cape Verde, and already has financing committed from the EC. Constraints for Praia include a lack of phone lines and comparatively less productive labor and more onerous bureaucracy than elsewhere in the country.

6.19 Mindelo is hampered by the worst airport of the three and relatively less reliable water and electricity service. Moreover, the industrial sites presently being studied all have some defect. On the other hand, Mindelo has the best natural port, the strongest private sector, and the most productive labor. Its culture is reportedly more open to foreigners and there is a stronger industrial tradition. Finally, high-level GOCV officials have stated that the concentration of activities in Praia over the past ten years makes it essential that Mindelo be given preference on any project of this sort.

6.20 Considering the strengths and weaknesses of Mindelo and Praia it seems evident that the two regions can play a complementary role. Mindelo -- with its strong port and weak airport -- is a more sensible choice for investors producing less time-sensitive products like uniforms, work gloves, etc. In addition, Mindelo is also clearly the logical choice for any bulk or break-bulk CFZ activity.

6.21 Praia, with the establishment of direct air service to Portugal in 2-3 years, will have an advantage with the production of high value-to-weight goods that are time sensitive in nature. This could include anything from high fashion items to electronics and jewelry. Similarly, because of Praia's air links with West Africa, it is a better choice for luxury goods CFZ activity (though this appears to have limited potential at this time as will be discussed in Chapter VIII.)

6.22 Countries that have encouraged multiple private zones have found that strong regional competition can emerge, leading to increased levels of facilities and services, thus benefitting both the IFZ firms as well as the country as a whole. In Cape Verde's case, it seems as though healthy internal competition would benefit both Mindelo and Praia.

B. POTENTIAL EXTERNAL SOURCES OF FINANCE

6.23 Given the limited financial and technical resources available domestically in Cape Verde for industrial estate development, it is likely that external financing and technical assistance will be required to develop an industrial estate or IFZ. This is not necessarily a major constraint, and is typical of many developing countries embarking on IFZ programs. Various alternatives are available for each, the principal ones of which are discussed below.

1. Financial Characteristics of IFZ Projects

6.24 From a financial perspective, an industrial free zone is a real estate project configured for specific types of industrial and services activities, operating under a special set of incentives and regulations. As such, financing is required for both fixed asset development, and for working capital expenses associated with project development. Fixed asset development funding is typically required for the following:

- site acquisition and land preparation;
- development of internal infrastructure, including roads, electricity, water, sewage, telecommunications, etc. and preparation of land for building sites;
- construction of standard factory buildings, administrative facilities and other buildings which may be required;
- development of external infrastructure (e.g., external access roads, utilities infrastructure, etc.), separately or in conjunction with the responsible public sector utility company involved.

6.25 Of these different components, by far the largest is construction, which typically accounts for 75-80 percent of total project costs. The external infrastructure requirements are often put in as part of the investment programs of the public utilities responsible for each area, however this will depend on local practice and conditions. The developer of the zone is normally responsible for all internal infrastructure, which again may be installed with the cooperation of the responsible utilities. The land cost and preparation expense, as well as a portion of the internal infrastructure costs, are normally required up-front before construction can be undertaken. The typical development pattern will be to put in all the land improvements and infrastructure for each phase of construction, and then build individual buildings on demand, with a small inventory (one or two) of speculative buildings. The raw land cost must often be imputed, as it may be contributed by the local government, or be privately owned but not directly purchased for the project. However, the land typically forms part of the equity which can be leveraged for debt financing, and therefore a cost should be determined which reflects current market value.

6.26 Funding is also required to cover associated working capital costs such as personnel, office and relevant overhead expenses during the free zone construction period. Depending on local practice and lender requirements, these costs incurred prior to operations may be capitalized and financed from project sources. Once operational, working capital infusions may be needed until revenues are sufficient to cover direct operating expenses of administration, marketing, travel, maintenance, insurance, depreciation, debt service, and various contracted services.

6.27 As long-term industrial real estate development projects, with long (3-6 years) development periods, large capital costs (US$10-US$20 million or more), and long payback periods, free zones have specific and unique requirements for financing. Zone projects typically

require long-term finance (i.e., with a repayment period of at least 8 years, and 2 to 5 years grace period on amortization of the principal) to ensure that gross revenues are sufficient to cover all operating costs, including debt service. As with most term lending, the loans are normally collateralized by the zone assets.

6.28 Development of private free zones in developing countries has most often been undertaken by local private sector firms, or foreign firms with a strong local presence. These firms are typically not primarily involved in free zone development or construction, but usually have diversified interests and see investments in free zones as a means of further consolidating and diversifying their investments in the country. These firms have typically put up substantial equity in the projects, with debt/equity ratios of 60/40 or less, as local sources of lending for long-term projects has been difficult to secure.

6.29 This practice differs from that which is typical of industrial park development in the U.S., where the developer usually puts up little or no money, with the equity investment coming from financial partners or a group put together by the developer. These projects are normally highly leveraged, at 80/20 or even higher debt/equity ratios. Short-term construction finance is normally provided separately from the long term finance, as the projects, or phases of projects are mortgaged once they are leased out. Many developers will sell out of a project as it is completed to realize their gains at an early stage; these firms typically have no interest in management of the projects they develop.

6.30 Zones developed by government agencies or parastatals often are financed directly by donor agencies with a sovereign guarantee, and often for the total amount of the project, less the land value. Such financing may be on more concessional terms than sources available to private projects.

6.31 With respect to the currency of loans, free zones are normally quite flexible as projects. Because their tenants are export firms and in most countries operate freely in foreign currencies, zone rents are also often denominated in hard currency or linked to the dollar or other hard currency. Therefore, as with export-oriented projects, free zones can usually support dollar or other hard currency loans without the currency risks involved with other types of projects. The foreign currency component of free zone projects varies from country to country, but typically will be between 40 to 60 percent. For zones financed with local currency funds, access to foreign exchange for the imported components is critical.

6.32 Given these characteristics, many zone projects have relied on external financing from donor institutions with long term lending programs, or upon leveraging substantial equity placed by "deep pocket" investors with additional local borrowings. In some cases, other more innovative financing mechanisms have also been utilized, including securitization of lease revenues and debt/equity swaps. For Cape Verde, long term debt finance from a donor agency is the most likely source of funding for an industrial estate project, whether it is developed by a private group or government agency. In addition, the country has already successfully

mobilized foreign assistance grant funding for the up-front infrastructure costs of industrial zone development at Achada Grande.

2. Bilateral Sources of Finance

6.33 Most industrialized countries have Government corporations or agencies which offer programs to encourage and assist foreign direct investment in developing countries, through the provision of debt finance and investment insurance. These will include, for example, the Overseas Private Investment Corporation in the U.S., the Commonwealth Development Corporation in the U.K., Proparco in France, IFU in Denmark, etc. The organization and lending programs differ in each country, but generally have a comparable project finance function. Their programs differ on many criteria, such as requirements for equity participation by nationals, sourcing of goods financed, etc. They could conceivably play a role in the project if the development group includes foreign principals with a direct equity contribution. These agencies, however, do not have extensive experience lending to free zones or industrial estates. OPIC has financed two projects in Latin America, and has committed to financing IFZ projects in Togo and Cameroon provided they satisfy normal lending criteria.

a. Bilateral Foreign Assistance Agencies

6.34 A number of bilateral foreign assistance agencies have been active in supporting IFZ development. In particular, USAID has been at the forefront of free zone development in the Caribbean Basin and, more recently, in Africa. USAID has funded free zones both directly and indirectly, via grants and loans. Grants have been made available only to governments and non-profit organizations. Loans have been made through local intermediaries such as commercial and central banks. In addition, USAID has indirectly financed free zone activities in Costa Rica through USAID supported financial institutions who have financed private sector free zone projects.

6.35 For example, in El Salvador, USAID provided a line of credit of US$20 million in local currency in order to spur the development of a private IFZ. The loan has a 20-year term with a 5-year grace period. The interest rate reflects the Salvadoran Central Bank's interest rate policy as USAID loans are typically set at market -- rather than preferential -- rates. In Costa Rica, two USAID supported banks are investing with both equity and debt in two different private free zone projects.

6.36 Bilateral assistance agencies have also been active in funding technical assistance related to IFZ development, such as has been provided in Cape Verde through studies, legislation review, and the support of PROMEX.

b. Export Credit Agencies (ECA)

6.37 All of the major industrial countries have public agencies which provide special financing for their exports. Most of these programs have direct loan or loan guarantee programs designed to support exports of equipment and machinery which could not be made without financing. These credits are often provided at less than market rates. In addition, these agencies will often lend to countries to which private institutions will not lend because of debt servicing problems. These credits can only be used to purchase goods from the country that is supplying the credit -- these agencies, unlike the investment finance programs of OPIC and counterparts, exist to support exports and not to promote foreign direct investment. (Some institutions offer both types of financing programs under the same roof.)

6.38 The supplier applies for the finance, and uses it as an incentive to get the order. These credits, if available, could be quite effectively used to finance prefabricated buildings and equipment components of the free zone. Export Credit Agencies (ECAs) have country limits, but it is unlikely that Cape Verde is approaching the point of being constrained by these limits; or that a free zone would exceed them. For U.S. businessmen, the relevant ECA is the United States Export-Import Bank.

6.39 The terms and conditions of lending by ECA's is governed by the OECD Arrangement on Official Export Credits, an international agreement by OECD member states and their ECA's. The Arrangement sets minimum interest rates and other terms in an attempt to limit subsidized export finance as a competitive factor in international bidding. Eximbank abides by the OECD guidelines in its lending programs.

6.40 The direct application of ECA financing for free zone development was part of an arrangement that the Jamaica Industrial Development Corporation made with the Canadian Export Development Corporation (CEDC), the Canadian ECA in 1987. Using CEDC credits, the JIDC purchased some US$14 million worth of pre-fabricated industrial buildings for installation in various Jamaican free zones and industrial estates.

6.41 ECAs are a potential source of medium-term finance that could be accessed to develop components of the free zone. Such funding can be accessed under quite favorable terms and conditions given the stable financial position of Cape Verde, but will normally require a government guarantee.

3. Multilateral Sources of Finance

a. International Finance Corporation (IFC)

6.42 The IFC is an arm of the World Bank that supports private enterprises in developing countries. Its primary purpose is to put projects together by evaluating their financial viability, providing technical advice and providing both equity and debt finance. Loan guarantees are also

available to some projects. Generally, the IFC prefers to be a minority investor in projects, and usually limits its participation to 25 percent of the total project cost. Although waived in some cases, the minimum loan size is US$5 million. The maximum loan term is 15 years, although few loans are actually made of that length. The IFC typically requires substantial equity participation rates; in exceptional cases, they have financed projects with an 80/20 debt to equity financing structure. IFC will invest up to 20 percent of the equity in a project, primarily as a catalyst for other equity investors, and looks to sell out its equity interests to realize returns rather than hold its position for the long term.

6.43 Until recently, the IFC did not normally finance free zone projects as they were viewed as purely real estate developments -- projects which the IFC traditionally does not support. Early this year, the organization's position vis-a-vis IFZs has been clarified, and free zones are now eligible for IFC participation. The IFC has financed a private free zone in the Dominican Republic, and is considering another project in Latin America. The IFC has recently concluded an agreement to provide funding to the San Isidro Free Zone, an already operational private free zone in the Dominican Republic. IFC is also currently supporting the Mexican "maquiladora" program by providing a loan of US$20 million to a private bank to support the development or expansion of private industrial parks.

6.44 In many cases, funding from the IFC in the African region is accessed through the services of the African Project Development Facility (APDF, of which the IFC is the Executing Agency), which provides services in packaging financing for various types of projects. The APDF itself acts as a broker, and does not provide financing directly. The organization puts together the financing for a particular project for a 2 to 3 percent fee based on total financing provided. In addition to IFC resources, the APDF has access to funding from a wide variety of multilateral and bilateral agencies.

b. The World Bank

6.45 The World Bank lends only under sovereign guarantee to developing country governments or affiliated institutions. The World Bank has substantial experience in the financing of industrial estates, industrial free zones, and related facilities, usually owned by the public sector. For example, the World Bank financed the first industrial estate in Mauritius beginning in 1974 and the Kingston Free Zone in Jamaica, among others. In recent years, however, the World Bank has provided financing usually for the expansion of existing free zones, with a demonstrated performance track record, rather than entirely new projects. It is also indirectly supporting private free zone development.

6.46 An example of a recent World Bank Free zone project is a US$30 million dollar loan to the Dominican Republic. The World Bank began work on this loan, however, only after 15 years of successful free zone development in the Dominican Republic. Under this project, the loan will be rediscounted and "on-lent" by a first tier public intermediate financial institution to private free zone developers through second tier private financial intermediaries (commercial

banks) with the foreign exchange risk assumed by the final borrowers, the private free zone developers.

6.47 This type of rediscount program has several advantages. It can provide a range of lending options with different maturities to finance the different components of a free zone. Moreover, by channelling funds through a financial institution and charging market rates, it reduces potential official interference through reliance on the credit analysis and standards of private institutions. A specific free zone World Bank project loan usually also includes some funds for promotional and administrative activities.

6.48 More recently, the World Bank is supporting the establishment of a free zone at a 200 ha. site within the Athi River area just outside of Nairobi, Kenya. In this case, low-cost, long-term IDA credits are being utilized by the Government of Kenya to support the pre-investment engineering analysis, as well as, reportedly, the cost of internal building and infrastructure development. If configured in this way, this project would be a departure from the types of free zone financing activities that have been typically undertaken by the Bank. However, financing for the construction of the zone, which reportedly will be privately managed, has yet to be arranged.

c. European Investment Bank

6.49 The European Investment Bank (EIB) is a development banking institution that is capitalized by members of the European Economic Community (EC). Outside its operations in the EC, the World Bank is active in the twelve Mediterranean and 66 African, Caribbean and Pacific (ACP) countries that are signatories of the Lomé Convention. The EIB has had experience in industrial infrastructure development generally, and industrial estates in particular.

6.50 The terms and conditions of EIB debt finance are well suited to free zone infrastructure development. The Bank's lending policy is quite favorable, and does not generally limit funding activity by sector or by country. According to the EIB, debt financing for long-term infrastructure development projects in least developed countries like Cape Verde are available below market rates of interest. Term lending is available for 15 to 20 years at about a 3 percent annual interest rate, and a grace period on payment of the principal. Minimum project size requirements are flexible. However, the EIB normally lends to governments or with government guarantees, as it is essentially providing funds under the framework of the Lomé Convention. With the support for the early stages of the industrial estate development in Praia being provided by the EC, EIB financing for building construction or additional industrial zone development may be a viable alternative.

d. African Development Bank

6.51 The African Development Bank (AfDB) has relatively limited experience in project lending for industrial parks or free zones. However, it does have funds for both industrial and export development that could be very appropriately used to finance free zones. In the late 1970s, the AfDB, co-financed the free zones being developed by the Development Bank of Mauritius. More recently, the AfDB has agreed to finance a feasibility study of an free zone in Mombasa, Kenya, and has agreed to provide financing for its establishment if the results of the study are positive.

6.52 The terms and conditions of AfDB financing are very similar to that of the World Bank's IDA lending. For least developed countries like Cape Verde, the AfDB generally offers extremely concessional loans with a 50 year term, 10-year grace period and zero interest. For self-financing, export-generating industrial "enclave" projects such as a free zone, financing terms would be more market-oriented, with a 20-year term, 3-5 years grace, and a fixed interest rate of 7.5 percent per annum plus a 1 percent commitment fee on undisbursed funds. In the near future, the AfDB is likely to adopt variable rate financing like the World Bank.

6.53 Historically, AfDB financing has been limited to public sector projects. Recently the Bank has changed this policy and established a program for the financing of private sector projects without government guarantees. This program was launched in 1991. In addition, the AfDB has, on occasion, taken 20 percent equity in projects. According to private banking sources that work closely with the AfDB, the AfDB is currently very interested in export promotion lending and these sources believe the AfDB is apt to look favorably upon a well-structured free zone project loan.

4. Other International Sources of Finance

a. Africa Growth Fund

6.54 The Africa Growth Fund (AGF) is a privately owned, managed, and funded investment company that takes positions in profitable new and expanding business enterprises in sub-Saharan Africa. The Fund, which is owned by a consortium of U.S. corporations, was developed by OPIC and is managed by a subsidiary of Equator Bank. Started in 1989, the Fund has a lending base of US$30 million.

6.55 Typical Fund projects are between US$5 to US$30 million in capital costs and the Fund seeks investment opportunities where it can provide between 20 and 45 percent of a project's total equity; Fund investments therefore typically fall in the range between US$500,000 to US$3 million. The most frequently used investment structure is a form of convertible subordinated debenture, or the local equivalent, which combines current income to the Fund at or below local market interest rates with long-term ownership rights. Other possible structures include common and preferred stock, subordinated debentures, or income notes. Any project

must involve a serious U.S. equity or other interest, although the Fund has slightly more flexibility in this matter than OPIC. The Fund's investments must be supported by OPIC political risk insurance or alternative insurers such as MIGA, corporate guarantees, or other offshore collateral. For Fund participation, projects cannot be controlled by local governments or public agencies.

b. Commercial Banks

6.56 Since the onset of the Third World debt crisis in the early 1980s, most major foreign banks have endeavored to reduce their exposure in developing countries and are willing to provide new credits only on a very short-term basis, usually as trade credits, or as limited recourse export project lending. With the latter, the repayment of the loan is tied directly to the export revenues earned by the specific project. In many cases, special dispensation is required from monetary authorities to earmark foreign exchange revenues earned by the project towards debt repayment. In some cases, payment is made in product, putting the commodity price risk on to the lender as well.

6.57 This type of lending is now quite common for mineral and petroleum projects throughout the developing world. Indonesia used it to finance a billion dollar natural gas complex, while Chile has used it to finance new copper and iron mines. In most cases, these projects are undertaken by subsidiaries or consortia of large multinational enterprises. It is still rare for foreign banks to provide this type of financing to local firms, unless they have established an international reputation.

6.58 The possibility of private foreign commercial bank debt financing of IFZ development in Cape Verde is quite limited. While an individual bank could easily completely finance a free zone through limited recourse lending, it is unlikely that one bank would accept this risk. Rather, banks would generally insist that they cover only a part of the financing, and also try to ensure that their claims are superior to others. Rather than the full non-recourse project finance discussed above, banks will also try to structure their loans to foreign investors so that only a portion is tied to the zone project, with the rest assumed by the foreign investor or firm. Obviously, the investor will resist this commitment as it increases his potential liability, but such contingent liability may be the only way to access the necessary financing. Finally, banks will try to keep the maturities of their lending as short as possible.

C. EXTERNAL TECHNICAL AND MANAGEMENT ASSISTANCE

6.59 The lack of experienced organizations and individuals in Cape Verde to develop and manage an IFZ/industrial estate will probably require that external organizations or persons be involved in the execution of any project. This is not necessarily a major obstacle, and several alternative means of addressing this need are feasible and have been utilized elsewhere. The two principal alternatives are to involve a private industrial estate development organization in the

project, or arrange for the services of one or more individuals. The exact configuration will depend on the mode of IFZ/IE development; i.e. whether the projects are developed privately or publicly, whether foreign organizations can be interested on commercial grounds as principals, and the costs of contracting for the required services. The type of assistance which will be required will be in two principal areas: that of physical development and engineering, and industrial estate operations.

1. Foreign Industrial Real Estate Development Organizations

6.60 Major property developers in the industrial countries have only recently begun to undertake overseas projects as developers. A small group of firms, generally consisting of the largest and most sophisticated, have undertaken projects in other industrial countries, or in developing countries where they have commercial or other interests. It may be possible to attract the participation of such groups as principals in a private IFZ/IE project in Cape Verde, however, the small size of likely projects and the uncertainty of the market will probably preclude their participation as equity partners or developers.

6.61 The participation of such groups could be arranged on a contractual basis, with payments for fees to provide planning, construction management, and operational management and training. This is, however, likely to be an expensive alternative which will hobble the financial success of any proposed project. Unless payment for such a technical/management assistance contract can be funded by a grant from a donor institution, it should not be pursued.

2. Individual Technical Services

6.62 Given the small scale of potential projects, it is more reasonable to expect that the required technical assistance could be provided by an individual expatriate, or perhaps two. The qualifications of this person, i.e. whether he is by training an engineer or a management specialist, will depend on the needs of the organization developing the zone, which may have capabilities in planning or engineering, for example, and therefore the critical need would be for an IE management specialist.

6.63 This person could be contracted directly by the development organization for a 2-3 year period as the General Manager of the project, with the understanding he would be training a Cape Verdian counterpart for assumption of management responsibilities at the end of the period. IE management staffs are typically small, with the General Manager assuming a broad array of responsibilities. While relying on one person for the required expertise would not be as thorough as engaging a firm, it is likely to be sufficient. Additionally, short-term technical assistance from specialists could also be arranged from other technical services agreements and possibly funded by donor assistance. Qualified persons should be able to be recruited, although they would require a standard compensation and benefits package comparable to that provided for expatriate managers. It may be possible as well to fund the costs of this position, fully or partially, through

grant assistance. If not, the costs of an expatriate General Manager should be budgeted into the operating costs of the project for the first 3 years.

VII. ASSESSMENT OF THE CAPE VERDEAN LEGISLATIVE, INSTITUTIONAL AND REGULATORY ENVIRONMENT

A. KEY LEGISLATION GOVERNING EXPORT ACTIVITIES

7.01 Taken together, the four laws considered in detail here constitute a package of free zone legislation in everything but the name. They constitute a strong package of incentives for export-oriented industrial firms, which permit broad flexibility of location (including licensed factories). This package of legislation was developed by the previous government and appears to enjoy generally strong support.

7.02 Beyond its applicability to export-oriented industrial free zone development the legislative package addresses industrial investment throughout the economy. While it is outside the present terms of reference to analyze this entire package, a few comments are useful. Rather than conceiving of free zones as isolated test cases in the process of liberalization, free zones are but a single mechanism in the liberalization of the economy. Such broad liberalization augurs well for the development of a competitive business climate in which free zones can best succeed.

7.03 The foundation of this legislative package[1] is contained in the External Investment Law and the Law of Industrial Development. These laws establish the principal of equal treatment for external investment, affirm the government's commitment to a dynamic business environment and require the development of the Industrial Development Statute to regulate the granting of incentives and a simplified investment approval process. The Industrial Statute defines the approval process and incentives for industries, with special consideration for export-oriented industries. The Entrepot Law permits the creation of areas both for industrial purposes and warehousing, where merchandise is considered to be extraterritorial and thus not subject to Customs duties.

1. External Investment Law - Law No. 49/III/89

7.04 Passed by the National Popular Assembly (ANP) together with the Industrial Development Law on July 13, 1989, this legislation establishes the framework (including "the rights, guarantees and incentives") for the treatment of external investment in the country. The basis of the law is to assure "just and equitable treatment" for external investment, moreover the

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1 The hierarchy of legislation in the Cape Verdean system is as follows: Lei (Law) -- denotes legislation specifically passed by the National Popular Assembly; Decreto Lei (Decree Law) -- denotes legislation enacted by the government on instructions from the ANP; Decreto (Decree) -- denotes legislation (or regulations) enacted by the government on its own initiative; Portaria -- denotes a regulation enacted by a Ministry; and Despacho -- denotes a regulatory ruling.

law goes beyond that to guarantee external investors the right to expatriate the returns from a project.[2]

7.05 One important nuance to appreciate is that the law specifically refers to "external investments", where these are defined as "all participation in economic activities ... which can be assigned a monetary value and originate outside the country." The intention here is to provide equal access to these benefits for non-resident Cape Verdeans as for foreign investors. Non-discrimination against local investment is an important benefit in free zone legislation as it avoids the formation of a foreign enclave with special privileges, which can become the object of resentment.

7.06 However, there are two important areas where the legislation discriminates against external investment made by "non-emigrant" Cape Verdeans.[3] Non-emigrant Cape Verdeans are not guaranteed convertibility and expatriation of the returns on their investment (Article 10), and are also not permitted to open foreign exchange accounts (Article 18). Depending on how the status of "emigrant" is defined in subsidiary legislation, the problem of convertibility could have a negative effect. Regarding foreign exchange accounts, the Industrial Statute (Article 50) authorizes foreign exchange accounts for all "industrial export enterprises," so the exclusion of Cape Verdeans in Article 18 is without effect. In contrast, the Industrial Statute does not guarantee repatriation to any investors. Discriminating against Cape Verdean external investment in either of these ways will only discourage Cape Verdeans who hold foreign exchange outside the country from making investments, and thus will not allow the country to maximize its development potential.

7.07 Investment is permitted in the following sectors:

- Transformative and Extractive Industry;
- Hotels and Tourism;
- Industrial Fishing and Aquaculture;
- Agroindustry;
- Export and Re-Export;
- International Maritime Transport; and
- Support Services to these Activities.

7.08 In addition to these sectors, additional areas may be authorized solely through a Decree of the government.

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2 External investment here refers both to investments made by Cape Verdean emigrants and to foreign investors. The principal concern of this registration is to provide for transfer of the investor's resources out of the country in the future.

3 The difficulties in classifying foreign investors, emigrant Cape Verdeans, and resident Cape Verdeans is acknowledged by the fact that an upcoming regulation will try to define the differences.

7.09 Expropriation is permitted after a "Declaration of Public Utility". However, the likelihood of such an occurrence is limited by a requirement for "fair market value" indemnification, where such value would be determined by a standard three member arbitration panel (one member representing each of the parties with a third chosen jointly). In the event of an impasse, final determination would be made through the International Center for the Settlement of Investment Disputes (ICSID). In addition, all disputes with regard to external investments would be subject to this same arbitration and settlement procedure.

7.10 Fiscal incentives and the holding of accounts in foreign exchange are authorized in general, and permission is granted to the Government to establish by Decree Law the specific applicability. Decree Law No. 110/89 (the regulatory legislation setting these details) specifies that for the initial five years of operation, dividends may be freely expatriated without tax, and that for the next fifteen years dividends may be expatriated with a flat tax of ten percent.

2. Industrial Development Law - Law No. 50/III/89

7.11 Passed by the ANP together with the External Investment Law on July 13, 1989, this legislation sets forth "the objectives, the principles, the means and basic instruments, and the policy framework for industrial development." The practical function of this law is to define the general boundaries of the political consensus regarding the liberalization of the economy. Under the guidelines of this framework, authorization is granted to the Government for promulgation of an Industrial Statute (by Decree Law) which will specifically regulate industrial activity.

7.12 The law cites as a fundamental objective "the contribution of industrial development to the formation of a viable national economy, and to the betterment of the quality of life of the population." In line with the comments made in Chapter III regarding the precarious external balance and the small role played by industry in the GDP, the present legislation has as one of its specific objectives "to reduce the disequilibrium in external economic relations."

7.13 Specific reference is made (in Article 6) to equality of treatment for foreigners, however, this reference is circumscribed in such a way as to leave open the potential for special (discriminatory) treatment of foreigners. The External Investment Law with its arbitration guarantee provides sufficient protection on this account.

7.14 Sanctions are provided (Article 25) for non-criminal violations of the "laws and industrial regulations". Possible sanctions include fines and the suspension of benefits. Due process is specifically assured.

7.15 The section on Labor Policy (Article 31) states the following: "Without prejudice to the adequate protection of workers, labor policy will seek to respond to the specifics of industrial activity, and the necessity to give incentive to productivity and guarantee the competitiveness of industrial enterprises." While the implications of this statement are ambiguous, it could be read

to endorse a liberalization (or certain exceptions to) of the labor code. (See section VI.A.6. for a discussion of potential difficulties in the present labor code.)

3. Industrial Statute - Decree Law No. 108/89

7.16 Promulgated by the Government and published on December 30, 1989 this legislation defines "the conditions for industries to access and exercise the incentives for industrial activity, the supervision of compliance and the sanctions for their violation", as well as "streamlined administrative procedures."

7.17 As mentioned above, the present legislation applies to all industries, whether they produce purely for the internal market, export some portion of their production, or produce exclusively for an external market. The present review will focus on firms producing exclusively for the external market, which are referred to in the legislation as "industrial exporting enterprises."[4] The incentives offered to exporting firms are the most extensive, but to some degree all industrial firms obtain benefits. The discussion below will indicate those areas where incentives differ between firms addressing different markets. (It should be noted that the Entrepot Law also offers its benefits to firms addressing all markets, with payment of duties required only when goods pass into the domestic market.)

7.18 The first major section in the legislation defines the procedures for qualification of the benefits. Section VI.B.1 of this report considers this qualification process at length; detailed discussion is deferred until then. In summary, the process is a streamlined one, with a default approval mechanism built-in so that projects will not be delayed by bureaucratic inaction.

7.19 Any industrial firm may recruit foreign workers up to a limit of ten percent of its full time work force, according to Article 27. At the present time there are few foreign workers in Cape Verde, but they reported little difficulty in obtaining work permits or visas. A level of ten percent is generally sufficient for all practical needs over the long term. The law provides for exceptions to the stated limit, should a special case such as training program require additional personnel. Foreign workers may expatriate up to 70 percent of their salary (100 percent of their salary while on vacation outside the country), and they have rights for duty free importation of personal effects and an auto. In keeping with the principal of non-discrimination, non-resident Cape Verdeans receive the same benefits as foreign workers.

7.20 Customs incentives vary in a complex and sometimes ambiguous manner depending on the market a firm is addressing; a simplification of this section would be desirable in any legislative review. Essentially, industrial export enterprises may import whatever they require free of duties and quantitative restrictions. This includes merchandise from capital goods to raw materials to even diesel fuel. Imported materials purchased on the local market are also eligible

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4 Although, even firms producing exclusively for the external market can sell up to five percent of their production domestically, and in approved cases this percentage can even be higher.

for a rebate of duties. Partial exporting firms can obtain almost the same benefits as above, but they must specifically apply for industrial entrepot status. A summary of the various incentives follows:

- "capital goods, primary and subsidiary materials, spare parts, semi-finished and finished products, and other materials necessary for the realization of their stated industrial projects" may be imported without quantitative restrictions (Articles 30, 32, & 48);

- firms which qualify as "industrial exporting enterprises" are granted the status of "industrial entrepot" (see section VI.A.4.) without additional formalities, aside from an inspection of their premises by Customs -- this permits importation of "primary and subsidiary materials, and finished and semi-finished products" with "suspension of tariffs and other Customs fees, taxes, prohibitions and other commercial policy tools" (Article 33);

- all industrial enterprises may import free of tariffs, consumption tax and Customs emoluments:

    - "construction materials for industrial plants;"

    - "machines, apparatuses, instruments and utensils when destined for buildings and machines of an industrial firm;"

    - "machines, apparatuses, instruments and utensils when destined for the initial installation of administrative and corporate offices of an industrial firm;"

    - "material for the loading and transport of merchandise" (Article 34).

- industrial export enterprises may import free of tariffs, consumption tax and general Customs emoluments "combustibles and lubricants (with the exception of gasoline) utilized strictly in the production of goods for export (including the production of electricity and desalinated water for industrial consumption)" (Article 35 et al);

- export or re-export does not require prior authorization (formerly BPRE was required) and is free of tariffs and general Customs emoluments (Article 35);

- reimbursement of tariffs, consumption tax and general Customs emoluments on goods not directly imported by an industrial export enterprise (Article 35).

7.21 One potentially troublesome clause at the end of the section on Custom's incentives (Article 37) states that these benefits will only be conceded on goods "not produced in the

country in similar conditions of price, quality and availability." As a matter of business practice, a firm would be foolish to import goods locally available meeting these conditions. Nevertheless, the Government should not be in the practice of reviewing such business decisions. This clause is open to interpretation which could cause serious difficulties for the whole legislative incentive package.

7.22 The fiscal tax incentives, like the customs incentives, vary in a complex and sometimes ambiguous manner depending on the market a firm is addressing. A simplification of this section would also be desirable in any legislative review. For industrial export enterprises, Article 49 gives a ten-year exemption from corporate income and complementary taxes (Contribuicao Industrial and Imposto Complementar). After the expiration of this period a maximum taxation rate of fifteen percent is guaranteed. For partial exporting firms there is a three-year tax exemption, followed by a seven-year period where their taxes are reduced according to the proportion of their production which is exported. Following this, their taxes are reduced by an amount equal to 70 percent of the proportion of their production which is exported.

7.23 A note of concern regarding the possible implementation of these tax incentives is raised by the experience of one firm, which operates under a special Convention. Although the firm received a total tax exemption in its Convention, it was told that its tax exemption would no longer exist after the government learned of its profits. Upon protest by the firm, the GOCV withdrew from this position. Similar confusion regarding taxation would be severely detrimental to a free zone program. It is essential that the GOCV remain transparent and consistent in its dealings with the private sector.

7.24 Industrial export enterprises are permitted to open accounts in foreign exchange and to freely make any overseas payments they want. In practice this means that they are not affected by the "plafond" system and are not required to file the Boletim Registo Previo de Imporatcao (BRPI).

7.25 One inconsistency here is that all local debts and payments (i.e., payments in Cape Verdean Escudos) must be made from a special account in Cape Verdean Escudos, which can only be credited by a transfer from the firm's foreign exchange account (Article 51). As the clause presently reads, it appears as though local investment and proceeds from domestic sales could not be used, as the proceeds from these actions will be in Cape Verdean Escudos (which according to this article the firm would not be authorized to spend).

7.26 Sales to the local market are permitted, with the permission of the Director-General of Commerce, up to a level of five percent of production. This proportion can be increased by the Ministry of Economy, Transport, and Communications (METC) when in the interest of Cape Verde.

7.27 Sales from local firms to exporting firms are considered export sales and thus receive the same incentives as available to partial exporting firms. Moreover, the purchaser of these goods will receive a rebate of duties paid to allow local suppliers to better compete with

international suppliers. These provisions should prove useful in reducing the enclave nature of these industries by creating incentives for the generation of backward linkages.

7.28 This law is regulated and enforced by the METC, with the exception of the provisions relating to taxes and Customs, which are regulated by the Ministry of Finance and Planning with the advice of the METC.

7.29 Finally, although it is part of the implementing regulations and not the law itself it is useful at this point to note that the following industrial sectors -- among many others -- are eligible for benefits (according to Decree No. 157/90, part of the implementing regulations of the Industrial Statute):

Industrial Activity	Code
Assembly of articles of clothing in series	3220.1.0
Construction of typewriters and computers	3825.1.0
Construction of radios, televisions and telecommunications equipment	3832.0.0
Works of infrastructure, preparation and construction of industrial installations	5000.1.0
Data processing	8323.1.0
Services to industrial enterprises, not elsewhere classified	8329.1.0

7.30 The fact that construction of industrial facilities is included as an eligible operation is particularly important as this incentive will greatly increase the likelihood that private developers will undertake the construction of IFZ/industrial estate facilities, removing this burden from the Government.

4. Entrepot Law -- Decree No. 27/89, 5/27/89

7.31 Promulgated by the Council of Ministers and published on May 27, 1989, this legislation establishes the concept of a Customs entrepot. Specifically, this permits the deposit of "merchandise in a specific location, under the control of Customs, with the suspension of tariffs, and other Customs duties, taxes, prohibitions and other economic policy measures."

Entrepots are divided into two categories: warehouse entrepots and industrial entrepots. The entrepot law provides a basis for CFZ activity by allowing private bonded warehouses without a double key facility.

7.32 The merchandise permitted into an industrial entrepot includes: "primary and subsidiary materials, and finished and semi-finished products destined for incorporation, transformation and processing of the manufactured products" of the industrial firm. In effect it permits the operation of a factory building located anywhere within Cape Verde as a duty-free zone. The Director-General of Customs is empowered to expand the list of materials which can enter a given industrial entrepot. Supervision is exercised on a "paper control" basis, as specified in the regulations issued by Customs, rather than through continuous physical inspection. This is important, as it means that Customs does not need an agent at each entrepot providing physical control, a relatively expensive and cumbersome method. Instead, entrepot users can merely post a bond.

7.33 The law is also well formulated in that taxes on sales to the domestic market are made after the sale, rather than upon importation of the goods into the warehouse. The latter system, which is known as a drawback, has been found to be unresponsive in many developing countries.

7.34 Any industrial firm (exporter, partial exporter, or domestic producer) can utilize an industrial entrepot. Exports leave without the necessity for ever paying duty, while any products sold into the domestic market pay the duties that the raw materials would attract (rather than the, normally higher, duties on the finished goods). This system is advantageous because it does not require the firm to tie up resources by paying the duties and then filing for a rebate.

7.35 The concept of a warehouse entrepot, which can be either private or public, is in essence a reclassification of the existing duty-free warehouse (which can function under either the "*afiançado*" system or the "*alfandegado*" system. Afiancado refers to a system where a bond is posted to guarantee the goods stored in the warehouse, and alfandegado refers to a system where a double set of keys are held by Customs and the warehouse owner. For a commercial free zone, the bonded system would be more suitable. The present legislation permits goods to remain within a public warehouse entrepot for up to three years (with possible extension to a fourth year).

5. Regulations Implementing the Free Zone Legislation

7.36 Regulation of the first three laws mentioned above are to be handled by a total of thirteen regulations (according to the original plan of the Ministry of Industry and Energy). Along with the unequal treatment of local and foreign investors, this diffusion of legislation must be seen as one of the main weaknesses of the incentive package. As of May 1991, six of the thirteen have already been enacted and the remaining seven are in various stages of completion. The enacted regulations are:

Decree Law No. 110/89, 12/30/89 -- Establishes the regime of exemption and fiscal stability for external industrial investors;

Decree No. 155/90, 12/22/90 -- Regulates prior authorization for external investment (and the transfer of external holdings);

Decree No. 156/90, 12/22/90 -- Regulates prior authorization of imports of industrial enterprises made through the purchase of foreign exchange;

Decree No. 157/90, 12/22/90 -- Defines "industrial activity" under the Industrial Statute;

Portaria No. 1-F/91, 1/25/91 -- Establishes rules for the handling of toxic materials;

Portaria No. 1-G/91, 1/25/91 - Defines a "small industrial project" under the Industrial Statute.

7.37 The regulations still to be enacted are:

Legislation to regulate the rights of emigrants in comparison with foreign investors;

Portaria to regulate the Prior Declaration of Projects and the Industrial Registry;

Portaria to regulate the Inspection of Premises;

Legislation to regulate the procedures for the concession of fiscal incentives under the External Investment Law and the Industrial Statute.

Despacho from the Ministry of Public Finances to apply these incentives to existing enterprises;

Portaria regulating technology transfer and technical assistance;

Regulation concerning foreign exchange accounts.

7.38 Although the laws specified that the implementing regulations would be completed within 120 days, more than half of the necessary regulations have not been completed after one and a half years.

B. OVERVIEW OF EXISTING REGULATORY/INSTITUTIONAL FRAMEWORK AND PROCEDURES

1. Administrative Procedures

a. Investment Approval

7.39 The investment approval process to obtain the benefits noted above is regulated by a streamlined procedure as elaborated in the Industrial Statute and its subsidiary regulations. The approval process was designed to eliminate the need for pre-feasibility and/or detailed market analyses for government review. In that sense, this process marks a significant departure from past GOCV policies. The process involves three stages with built-in default mechanisms to assure tacit approval if government action is not forthcoming. In the course of qualifying for these incentives, the normal process of incorporation, with the payment of standard fees, must occur. The three stages are:

ONE: Prior Declaration of the Project

TWO: Registration of the Company and Confirmation of its Projects in the Industrial Registry

THREE: Site Inspection

7.40 It is anticipated that the timing of these actions would roughly correspond to the following stages of project development: Prior Declaration would correspond to the project identification or pre-feasibility study stage of a project (ie, before investors have begun incurring substantial expenses), Entry into the Industrial Registry would occur with the completion of the detailed market and feasibility studies (ie, when investors have decided to go ahead with the project), and Inspection of the Premises would occur immediately prior to start-up of operations.

7.41 Prior Declaration of the Project (Declaracao Previa). Prior Declaration is designed as a mechanism to give firms an early "green light" on projects they are considering. It is intended that before firms begin spending money on market and feasibility studies, they can obtain a pre-approval of their eligibility for the incentives.

7.42 The first action is to confirm that the intended project is in an eligible industry segment. The list of eligible industries is published in Decreto No. 157/90, 12/22/90, and is very broad. As discussed above it includes most common free zone industries including: garment assembly, electronics assembly, data processing, as well as the construction of industrial buildings and the provision of services to industrial companies.

7.43 The next step is to file the Prior Declaration form. When external investment is involved two additional forms are required: a Request for Authorization of External Investment (Pedido de Autorizacao para Investimento Externo) and a Request to Register External

Investment (Pedido de Registro para Investimento Externo). All three forms may be obtained from the Director-General of Industry (DGI). The first form, the Prior Declaration, has not been published yet, but the second two are each only two pages long. The Prior Declaration is intended to request information of a general character, allowing for estimates, and permitting reasonable changes in the future. The first two forms, the Prior Declaration and the Request for Authorization are returned to the DGI, and the last, the Request to Register is returned to the Bank of Cape Verde.

7.44 Within five days of submission the investor will receive a confirmation that his declaration has been accepted. If there are problems these will be noted, and he can correct them and resubmit his package.

7.45 Within thirty days of acceptance, the investor will be notified of one of three decisions:

- No opposition to the project -- the "green light" to proceed;
- Opposition to the project, specifying the reasons -- in which case the investor can appeal the decision, amend his Prior Declaration, or desist from his project; or
- Proposal for the negotiation of a Convention of Establishment -- for those projects of large economic impact or which require exceptions to the general law.

7.46 If the investor has not heard from the DGI within 30 days, he may contact the DGI, confirm the acceptance of his Prior Declaration, and proceed with his project under a tacit decision of no opposition. Such tacit decision will be binding upon the government.

7.47 Registration of the company and confirmation of its projects in the Industrial Registry (A Inscricao da Emprese e o Averbamento dos Projectos no Cadastro Industrial). The creation of a corporation qualified to do business in Cape Verde is a relatively simple but expensive proposition. The first step is to qualify a company to do business in Cape Verde, either through forming a Cape Verdean corporation or registering a subsidiary of a foreign corporation. The fees are the same for either alternative. There are two taxes required to complete the registration process: the Stamp Tax (Imposto de Selo) and the Notary Emolument (Emolumentos Notariais). The first of these is assessed at one percent of the capital of the company, while the second is assessed according to the following scale:

Capitalization (in 1,000 CVE)	Rate per 1,000 CVE
<= 1,000	12
<= 10,000	8
<= 20,000	6
> 20,000	4

7.48 Firms are required to demonstrate the value of their paid-in capital by having the entire amount deposited (if only briefly) in the BCV, or in the case of contributions of goods and services, by demonstrating the value of the same upon their importation or execution. This requirement seems to be based on the assumption that firms should not be able to repatriate more than they have invested. This requirement can not only complicate the registration process, but is unnecessary for export-oriented firms which are allowed to repatriate profits and dividends freely.

7.49 In practical terms, this means that an apparel factory making an investment of US$500,000 will pay 1.4 percent of this amount (US$7,000) in the process of qualifying to do business. This figure compares to corporate registration fees of generally less than US$100 in the United States; IFZ programs typically have no such fee, although a few have an application processing fee of up to US$1,000.

7.50 Registration of the company and confirmation of its projects in the Industrial Registry (Cadastro Industrial) is the step which provides the necessary detailed information to the government (Commerce, Customs, Finance, Bank of Cape Verde, etc.) to enable granting of the rights and privileges contained in the Industrial Statute. It is essentially an enlarged and detailed version of the Prior Declaration.

7.51 Registration in the Industrial Registry can take place any time after a firm is legally constituted to do business in the country. It is done through submitting the appropriate forms, which as before, can be obtained from the DGI. While registration is necessary only one time, a renewal card must be submitted each year before January 31.

7.52 Confirmation of the project can happen simultaneously with the registration, or at any time after. Likewise it is done through submitting the appropriate forms, obtained through the DGI. (Neither these forms, nor the registration forms, are yet available). Upon verification of the information on the forms, the investor will be sent a Certificate of Project Confirmation which will entitle the company to the benefits of the law including tax and tariff exemptions.

7.53 The Certificate of Project Confirmation need only be issued once, although it may be amended. Since it confers benefits useful in the startup of the project (i.e., duty exemptions on equipment and building materials), it is important to obtain the certificate in advance. The Certificate will not be issued if more than twelve months have passed since the Prior Declaration was accepted, unless a timely justification is provided for the delay.

7.54 Site Inspection (Vistoria as Instalacoes). Before startup of operations a site inspection must be made by a committee composed of representatives of the DGI, the Department of Health, and the Municipality to confirm that the conditions of physical security, health and safety are met.

7.55 The DGI has thirty days from the receipt of a request for a site inspection to coordinate it. If thirty days pass then the company can begin operations under its own responsibility without

prejudice to the inspection when it does occur. Limited operation prior to the site inspection for testing of equipment is permitted.

b. Customs Procedures

7.56 The customs procedures for operation of an industrial entrepot (which is how all free zone companies would operate) are relatively straightforward and simple. They are contained in Service Order No. 1/90 issued by the Director-General of Customs.

7.57 The company requests entrepot status from Customs indicating the goods to be produced, and the required inputs. Presumably this information can be the same as that submitted for registration in the Industrial Registry. Customs, together with the DGI, issue an opinion on the conversion factors for transformation of raw material into finished goods. These conversion factors are used to relate goods entered into the entrepot to goods exported from the entrepot.

7.58 Customs control is exercised through a set of two cards, one for imports (Ficha de Entrada em Entreposto Industrial) and a second for exports (Ficha de Imputacao), with duplicate copies maintained at the Customs office and the entrepot. Periodic inspections are made to ensure compliance. The few firms currently using this system report satisfaction with its implementation and operation. Reportedly, Customs will send an inspector to a factory (or warehouse) to seal or open a container for no additional charge than if the inspection took place in the port.

7.59 The system this replaces (and the one still in effect for non-eligible firms and industries) was a multi-step process that required a pro-forma invoice from the supplier, a BRPI, approval for access to sufficient foreign exchange, a freight invoice from the shipper, an unloading invoice from ENAPOR, a customs declaration, verification/re-verification of the declaration, and finally payment of Customs duties. The general practice is to hire a Customs broker to negotiate merchandise through these procedures. Even with a broker handling the process the normal time to clear goods through Customs has been around three weeks from arrival at the dock (although, the time required has dropped to only one week or less after a recent bureaucratic streamlining).

7.60 There are many reports of firms encountering aggravations with Customs. One firm reported being unable to clear spare parts through Customs free of duty, because they "had already imported enough spare parts." Another firm reported that to get spare parts it was quicker and easier for them to send someone to Europe who would then return with the part. Other firms noted that clearing goods has sometimes taken months.

7.61 The Customs clearing process is reported to be much quicker in both Mindelo and Sal than Praia, and also comparatively quicker at the airports than the ports. In general, the interviewees noted that Customs is relatively free from corruption, although small tips can

accelerate the process. Instead, complaints focused much more on the bureaucratic difficulties described above. It should be mentioned however, that since April 1991, there has been an effective effort to streamline the Customs clearing process and goods are now being cleared much more quickly. Nonetheless, the clearance of goods in 3-4 days must still be considered uncompetitive, as successful IFZ programs typically clear goods in under 24 hours.

c. Foreign Exchange Regulations

7.62 Foreign exchange regulations for the operation of industrial export enterprises are contained in Article 50 of the Industrial Statue and an as yet unpublished regulation to be issued by the Ministry of Finance and Planning. Although the regulations have not been completed, it appears as though the procedures will be relatively simple.

7.63 Industrial export firms are permitted to open accounts denominated in foreign exchange at the Bank of Cape Verde (and presumably other banks when such come into operation, although the law now states only the BCV). Accounts can generally be opened in 24 hours and firms with these accounts have reported few problems with their operation. Firms are then permitted to "freely realize all foreign exchange transactions" without any type of prior authorization.

7.64 As mentioned above in the discussion of the Industrial Statute, there is an inconsistency in Article 51. It requires that all local debts and payments (i.e., payments in Cape Verdean Escudos) be made from a special account in Cape Verdean Escudos, which can only be credited by a transfer from the firm's foreign exchange account. The illogical effect of this is that local investment in an industrial export firm and sales to the local market are discouraged, as the proceeds from these actions will be in Cape Verdean Escudos (which according to this article the firm would not be authorized to spend).

7.65 The prior system for access to foreign exchange (and the one which domestic industrial firms, retailers, etc. must still use) is referred to as the plafond system. Each importer is assigned a plafond (roughly equivalent to a quota) which is their foreign exchange budget for the year. Firms are then free to spend their plafond, on a quarterly basis. The Bank of Cape Verde then uses this schedule to manage its foreign exchange reserves.

7.66 When a firm, operating under the plafond system, desires to draw upon its foreign exchange allocation it must initiate the process by obtaining a pro forma invoice and filing a BRPI (see the previous section regarding Customs procedures). The BCV must approve the foreign exchange allocation before the goods are imported, and then upon their receipt will execute the payment for them.

7.67 While this system sounds cumbersome and restrictive, industrial (though not commercial) firms report that for the most part it is flexibly administered. Companies that have

required additional unexpected imports in the middle of a year have gotten access to foreign exchange.

2. Overview of Key Institutions Overseeing Export Activities

a. PROMEX

7.68 The Center for the Promotion of Investment and Exports (Centro de Promocao do Investimento e das Exportacoes, or PROMEX) was authorized by Decree No. 69/90, 8/27/90 and receives significant financial assistance from USAID. The preamble to the authorizing legislation notes that PROMEX "exists as the principal entity charged with the orientation, dynamization, coordination, and implementation of investment and export promotion policy. In this matter, it is responsible for the horizontal coordination of the public and private sectors".

7.69 As organized in its Bylaws (Estatutos), PROMEX is governed by a Coordinating Council (Conselho Coordenador) composed of between eleven and fifteen members from the public and private sectors. The public sector members must include a representative of the Bank of Cape Verde, and Director Generals from Finance, Planning, and Commerce. The private sector members "will be proposed by organisms and institutions of the referenced sector," and at least one third of the members of the Coordinating Council will represent the private sector. To date however, members of the Council have not yet been appointed.

7.70 The method of how these Board members will be selected is not specified. As PROMEX "exercises its action under the oversight of the Prime Minister," lacking any further specification the Board members could be appointed by the Prime Minister. Possible private sector members include the two commercial associations, the industrial association (presently being organized), Customs brokers association (presently being organized), and the bar association.

7.71 Among various duties, the Coordinating Council is specifically required to approve the list of personnel and salaries, as well as reviewing the plan of action and the budget.

7.72 The remaining executive organs of PROMEX are an Executive Council and a President. The President is named by Decree of the Council of Ministers. The Executive Council is composed of the President and two other members of the Coordinating Council (at least one of which must be from the private sector). The remaining members of the Executive Council are also named by Decree of the Council of Ministers.

7.73 Between the authorization of PROMEX (Decreto No. 69/90, August 27, 1990) and the present investigation, the parliamentary and presidential elections have intervened, dramatically changing the government. It appears that during -- and perhaps because of -- this interregnum, PROMEX has been in limbo.

7.74 Certain actions have been taken. A President has been named, a technical assistant has been provided by Swedish Aid (ASDI), and a support staff hired. PROMEX has moved into its rented headquarters. Over half of office furniture and equipment ordered has arrived. There has also been a search for professional staff with some preliminary decisions already made about staffing. Of the four Directors, two have been hired and the other two have been identified and all are expected to begin work by the first week in October, 1991.

7.75 Despite the good intentions of those involved in the planning to this date, significant reservations exist in the private sector concerning the staffing and functions of PROMEX. The business community, which initially viewed PROMEX as a voice for the private sector, has the perception that the organization has become another arm of the government and feels as though it has been removed from the critical stages of the planning process. (Despite the fact that a prominent member of Cape Verde's private sector was involved throughout this process.) Moreover, the private sector is extremely concerned that the staff will be dominated by officials from the past regime. To address these concerns, PROMEX representatives have met recently with private sector organizations in Mindelo and Praia to discuss a stronger private sector role in the organization. The fate of the National Chamber of Commerce, which elicited no interest from the private sector due to fears that it would be government dominated, is clearly to be avoided. In response to these and other potential problems, the Council of Ministers of the newly formed government met in June for the first time to discuss the role of PROMEX in the country's new economic program. The Council's decision was to reinforce the role of PROMEX and make it the central locus of export-led economic inititatives in Cape Verde.

7.76 It should be mentioned that as originally envisaged, PROMEX was to have a staff of 10-12 personnel, a typical size for a start-up organization of this type. At present, PROMEX's staff could number as many as 25 people, between its headquarters (21) and Mindelo Agency (4). This approaches the number of staff (31) found in the Investment Promotion Council (IPC) in the Dominican Republic -- a country of seven million people and 140,000 workers employed in IFZ firms. In parallel fashion, it should be noted that the IPC had only 10 staff members after its first year of operation while CINDE -- in Costa Rica -- started with 12 employees. Togo's promotion unit similarly has 10 staffers after a year of operation.

7.77 It is critical that the Coordinating Council be assembled as soon as possible. By naming the Council at this time, the private sector can be brought into the planning process and play a role in staffing decisions. Otherwise, the private sector is likely to remain suspicious of any personnel choices.

b. Ministry of Economy, Transport and Communications

7.78 The Ministry of Economy, Transport and Communications is the entity charged with the approval of firms under the industrial legislation package described above. The METC incorporates the former Ministry of Industry and Energy, which took the lead in developing this package of legislation.

7.79 Within the METC it is the Director General of Industry which is primarily responsible for contact with firms desiring to take advantage of the industrial legislation. The DGI provides initial information on applicability of legislation, provides application forms, is the point for submission of completed applications, communicates the responses of the government, maintains the Industrial Registry and coordinates site inspections. It is the Ministry, per se, which ultimately decides on approval of applications.

7.80 The Unidade de Promocao Industrial (UPI), which operated as a service of the DGI, has since the promulgation of Decreto No. 158/90 (12/22/90) operated as an autonomous institute, the Instituto de Promocao Industrial (IPI). The IPI functions as an interface for small and medium industry, and as such will probably have greater interaction with firms supplying IFZ firms than the IFZ firms themselves.

3. Evaluation of the Institutional and Regulatory Environment

7.81 The Cape Verdean enabling environment for free zone enterprises has two major players: PROMEX, which handles the marketing and promotion of Cape Verde as an investment location, and the METC/DGI, which administers the incentive package. The legislative package itself is relatively strong and sufficiently comprehensive. Despite the positive nature of the package certain weaknesses exist and include differential treatment for foreign versus non-emigrant investment, failure to guarantee repatriation rights in the Industrial Statute, and the large number of implementing regulations. Nonetheless, the environment is well oriented to encourage the development of an export-oriented program, and it is recommended that in the short-term, modifications be made to the existing documents rather than undertaking a complete overhaul of the legislation, given the long delays that the GOCV has experienced in the past in accomplishing these tasks. In the medium-term, a simplification and unification of the incentives would be recommended.

7.82 There remain several actions for PROMEX and the METC before these systems can begin to produce results. It is important now to strengthen PROMEX as an organization by selecting the Coordinating Council. This will broaden the support base by incorporating private sector influence, and help it to play the horizontal coordinating role envisaged for it. In addition, the formation of the Coordinating Council will enable the approval of a budget (as directed in the authorizing legislation) which will mean PROMEX has authority to begin committing funds.

7.83 A first priority once PROMEX is on its feet should be the development of a marketing program pitching the industrial legislation package as "THE CAPE VERDEAN FREE ZONE PROGRAM". The characterization of this complex package of legislation as a "free zone program" will serve to summarize and communicate the benefits quickly to potential investors. Moreover, while the legislative package itself is powerful, it is spread out over several pieces of legislation. A foreign investor on a first trip to Cape Verde needs to have access to a clear summary of what is necessary for doing business in Cape Verde, and how to begin the process. In this regard, the information booklet prepared by the DGI ("Informacao aos Empresarios e

Empresas Sobre a Nova Legislacao Industrial") does a good job of summarizing the application procedures for authorization under the Industrial Statute.

7.84 Simultaneously, the METC must push to ensure the completion of all regulations pertaining to the industrial legislation. No matter how powerful the legislation is, it does little good until firms can take advantage of it. The METC has drafts, or has been coordinating with other ministries on drafts of the remaining regulations. Finally, the METC must implement the Industrial Registry.

7.85 To summarize, the Cape Verdean legal and regulatory environment is relatively well designed and has the potential to be effective. However, it is not yet complete and it is unclear how well it will be implemented.

VIII. COMMERCIAL FREE ZONE DEVELOPMENT[1]

8.01 As discussed in Chapter II, there are basically two CFZ categories. The first concentrates on high value, high duty products such as jewelry, electronics, watches, and medical products. This form of CFZ typically combines aspects of wholesale duty-free shopping and exhibition centers. The second form of CFZ revolves around bulk and break-bulk transshipment and as such should be seen as an extension of port activities. Products normally handled include grains, cement, steel, and lumber. In terms of employment generation, either type would yields only minimal job creation.

8.02 It should be emphasized that the factors that determine the viability of a CFZ are different than those for an IFZ. The performance of an IFZ program depends on a large number of factors, particularly that of the cost and productivity of labor. In contrast, a CFZ program is largely dependent on the quality and cost of port services, as well as conditions in neighboring ports. Despite these differences, there is complementarity between CFZ and IFZ programs. Improved port operations necessary for CFZ firms would also benefit IFZ firms. Furthermore, increased shipping traffic will likely lower sea freight rates and allow for more regular shipping schedules.

8.03 As discussed in Chapter V, sea freight and port operations present some constraints to development in Cape Verde. The idea of establishing transshipment operations in Cape Verde has long been discussed due to what is perceived as the country's advantageous geographic position. However, this fact alone is not an advantage per se. Cape Verde's comparative advantage is related more to the port of Mindelo's relatively smooth operations by West African standards. It is this factor - more than anything else -- that allows for potential in transshipment activities.

A. BACKGROUND ON PROPOSED CAPE VERDEAN CFZ PROJECTS

8.04 High Value CFZs. At the present time in Cape Verde, a number of CFZ alternatives are being discussed. EMPA has studied the possibility of establishing an exhibition warehouse in Mindelo. Products would consist primarily of general goods such as household appliances. EMPA has some previous experience in re-exports as it has sold some Cuban products (refrigerators, ovens, toys, and alcohol) to West Africa. EMPA officials reason that by joining forces with a European trading company, such an exhibition warehouse could offer for purchase a large variety of goods at less cost than would be available elsewhere within Africa (particularly vis-a-vis the perceived high cost of French products). The primary market would be West Africans, who would theoretically prefer to purchase these items in Cape Verde because of the

[1] Much of the information in this chapter was provided by three sources: Bob Powell, Greystones, Inc.; GEM report, 1991; and B. Neugebauer, 1991 master's thesis.

political and geographic reasons, EMPA management had envisioned the primary market as Guinea-Conakry, Senegal, Mauritania, and Cote d'Ivoire. However, a recent decree has limited EMPA's activities to distribution of 15 basic needs items; this will prevent them from proceeding with the project, although it may be attractive for a private trading firm or consortium.

8.05 A second CFZ idea has not yet been studied but may eventually be considered by CENTROTEL -- a Sal-based hotel supply firm. CENTROTEL believes that once African nations end their boycott against South African goods, there will be great demand for these products in West Africa. Because these products are often less expensive and more technologically appropriate for the African market than European goods, it is assumed that there would be sufficient demand.

8.06 High Volume CFZs. A third idea being considered is the storage and re-export of petroleum products by ENACOL. ENACOL once exported jet fuel to Guinea-Conakry because of transport difficulties in Italy. A detailed prefeasibility study for this idea was conducted in 1986-87. The study estimated that to make the project viable, the first phase cost for additional storage space etc. would be US$8 million, which would allow for a capacity of 24,000 tons/month. A second phase would raise the project development cost to US$3 million, bringing capacity levels to 35,000 tons/month. The assumption behind the project is that while West African ports generally have good unloading facilities for petroleum products, they often lack sufficient storage space. As such, ENACOL would store these products for neighboring countries; ENACOL would not purchase petroleum products as it feels it is too risky given the volatility of oil prices. The prefeasibility study projected a payback period of seven years with an IRR between 17 and 26 percent. Job creation, according to ENACOL management, would be minimal. ENACOL is currently discussing the project with Petrogas and Chevron; however current financial problems of ENACOL may prevent them from proceeding with any new projects.

8.07 The fourth, and most delineated idea has been developed by ENAPOR and Greystones. This project would use the Port of Mindelo as a regional transshipment point for bulk and break-bulk materials. The IFC is interested in becoming a partner in the project, and is awaiting a study presently being undertaken by a Dutch consulting firm.

8.08 It is estimated that the project would require approximately US$5 million in investment, for the purchase of trucks and bagging facilities, as well as for the construction of additional storage space. The project is based on the assumption that Cape Verde has a good port by regional standards and has a geographically advantageous position astride trade routes. Reportedly, the feedback from U.S. and European shippers has been positive, and interest is strong if the port of Mindelo can decrease its handling costs while simultaneously decreasing

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2 For example, the cost of a return ticket between Conakry and Paris is US$1013 versus US$405 between Conakry and Praia.

loading and unloading times. Backers of the project feel confident that the US$5 million investment will allow that situation to emerge.

8.09 Transshipment is especially attractive to shippers serving West Africa because of the excessive delays often experienced in the region. For example, regional ports typically unload 15-25 tons/hatch/hour while Rotterdam can unload 1000 tons/hatch/hour. Consequently, if a ship with a daily operating cost of US$20,000/day (U.S.-flagged ships usually have daily operating costs between US$15-60,000/day) must wait 36 hours to unload 500 tons, it is far preferable to have the materials transshipped via smaller, more economical ships. In this case, the delay would raise incremental costs by US$60/ton. Thus, if a shipper can save 12 hours time, cost savings can be substantial, and as high as 33 percent in some cases. On the other hand, it is not cost-effective to transship lots of 10-20,000 tons, as the increased handling and storage costs (goods that are transshipped are handled two additional times) would generally negate any delays in unloading in the port of destination. For this reason, liquid bulk shipments are only infrequently transshipped.

8.10 Lots of less than 2000 tons would comprise the typical size transshipped, with substantial costs savings possible only on ships with daily operating costs above US$7500. Moreover, if a port is capable of unloading cargo at a rate faster than 1500 tons/day (only Matadi in Zaire is presently capable of this) it makes little sense to transship.

8.11 While EC and North American ships -- because of higher labor costs -- have higher daily operating costs, Cape Verde's potential transshipment market is not limited to developed country flagged ships. Moreover, the market would not be limited to food aid, anything in small lots would have potential -- including small amounts of containers.

8.12 Still, much of the cargo that would be ideal for transshipment in Cape Verde consists of food aid. The United States has provided on average over 442,000 tons/year in food aid to West Africa in the last three years. It is sent in approximately annual 300 shipments, 240 of which are under 1000 tons in size. Canada and the European Community also contribute large amounts of food aid to West Africa with Canada recently providing 65,000 tons and the EC at approximately 73,000 tons.

8.13 The potential for transshipment from Cape Verde is helped by the introduction of certain other factors. The Jones Act states that up to 75 percent of certain food aid cargos must be shipped on U.S.-flagged ships, if available at fair rates. As a result, U.S. food aid is often shipped by U.S. lines which have higher daily operating costs.[3] These lines are therefore more apt to be interested in using Cape Verde as a transshipment base. However, because there is only

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3 The higher operating costs are reflected by the gap in average shipping prices for U.S. food aid. Title I shipments on U.S.-flag ships average US$95/ton while non-U.S. ships average US$41/ton (figures include bagging). For Title II shipments, the corresponding figures are US$131/ton versus US$80/ton.

one regular line to Africa at present (Lykes), only 30-40 percent of U.S. food aid goes on U.S. ships.[4]

8.14 In terms of U.S. food aid, Title I recipient countries pay for and arrange for shipping. As the average bulk shipment is 15,000 tons, it is often too large to be economically transshipped. For Title II aid, the United States arranges shipping by public tender (20 percent of which goes by U.S carrier). Over the last three years, over 200,000 tons/year of Title II food aid were shipped to West Africa, with main recipients including: Burkina Faso, Cape Verde, Ghana, Liberia, and Mauritania. Of the total Title II shipments in 1990, 60,000 tons were in lots less than 1000 tons. In 1990, 211 out of 246 lots were under 2000 tons, thus making it a high potential item for transshipment.

8.15 The Neugebauer study on potential for Cape Verdean transshipment noted that the best potential markets would be cargo destined for Gambia, Guinea-Conakry, Guinea-Bissau, Liberia, Mali, Mauritania, Senegal, and Sierra Leone. These countries were selected on the basis of existing trade routes, port constraints, and geographic proximity to Cape Verde. The author projected that a transshipment project could yield US$7 million in benefits as a result of increased harbor dues, cargo handling costs, and bagging earnings (the labor component of bagging makes this operation attractive for low-cost labor locations). Job creation would be modest: according to ENAPOR officials, bulk-to-bulk operations would create fewer than 40 jobs while the movement of 2000 tons/day of bagged cargo would create work for 60 stevedores.

B. ANALYSIS OF CAPE VERDE'S CFZ POTENTIAL

8.16 The legislative and regulatory foundation for CFZ activity is, in general, sound. Entrepot status is reportedly given quickly and the fact that Customs is based on paper rather than physical control simplifies matters. Reporting requirements are said to be not overly cumbersome. The one problem in this regard is that entrepots are not given income tax holidays. The existence of a corporate tax incentives would greatly enhance the potential for these activities as they generally operate on low margins.

8.17 Commercial free zones of the high value variety such as Miami and Curacao rely greatly on air transport for both passengers and merchandise delivery. At the present time, Cape Verde's transport links make this type of venture extremely difficult. Because Sal is the primary international airport, it would be the logical location for a CFZ. However, it is unlikely that significant traffic could be generated for a CFZ given the international connections to Sal. The natural market for a CFZ would more likely be for West Africans who would access Cape Verde through Praia. For Africans coming from countries other than Senegal or Guinea-Bissau, a minimum four-leg trip would be necessary to reach Sal. This would be a significant deterrent to this sort of commercial activity as CFZ visitors usually desire to conduct their business within

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4 It could not be determined by the consultants whether Canada or the EC countries have similar policies to the Jones Act. Nonetheless, it is known that a substantial amount of Canada's food aid is delivered by foreign ships.

a 2-3 day period. EMPA's plan to establish an exhibition warehouse in Mindelo should be reconsidered given this constraint and a direct market study should be undertaken in West Africa to determine whether this idea is viable. Similarly, the lack of direct air connections and poor air freight service available make CENTROTEL's idea to sell South African goods impractical at the present time. These transportation problems, when combined with poor telephone service to West Africa (direct lines are available only to Senegal and Angola), make the potential for these activities appear limited, at least in the short-term.

8.18 The potential appears to be better for high volume CFZ activities. However, the market for these operations has yet to be demonstrated. The relatively large size of fuel shipments would seem to preclude ENACOL's project, but it may be that regional storage space is limited to a degree that makes this activity feasible.

8.19 Given that the port is well-run by regional standards and the relatively simple improvements necessary to implement this activity, the main remaining questions on the ENAPOR/Greystones project are the size of the market and whether the incremental shipping activity will economically justify the added investment. The fact that Cape Verde is geographically centrally situated and has a relatively good port does not ensure that it has a natural market. Hopefully, the answer to these questions will be clearer following completion of the GEM report.

8.20 In summary, while the factors determining the success of IFZ and CFZ programs vary somewhat, the existence of the two programs can be synergistic. With the possible exception of the ENACOL idea, the projects discussed above can be implemented without substantial investment in massive infrastructure, thus increasing their attractiveness as development tools. Lastly, the absence of a tax holiday for undertaking these activities must be viewed as a strong negative; the passage of a tax exemption for re-export operations could help stimulate these projects.

IX. CONCLUSIONS AND RECOMMENDATIONS

9.01 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 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 of the program must also outweigh the costs of implementing the program. The following discussion provides a balance sheet for Cape Verde's potential and makes a number of recommendations to increase the country's industrial exports.

A. EVALUATION OF BUSINESS ENVIRONMENT

1. Factors of Production

9.02 In analyzing Cape Verde's basic factors of production, it is evident that the country holds few strong comparative advantages for investors. The costs for water, electricity, and construction are amongst the highest of any IFZ program countries.[1] The cost of telecommunications, sea and air freight, though not among the most expensive, should not be viewed as being particularly attractive. Only on the cost of land -- which may soon be changed -- does Cape Verde hold a strong comparative cost advantage. The quality of infrastructure also places Cape Verde in a disadvantageous position. Cape Verde's water supply constraints are well documented, and telecommunications to both Europe and Africa are extremely difficult.

9.03 The cost, productivity, and availability of labor is good, as shown by the experience of SOCAL, a company typical of many IFZ operations. Prevailing wages, although not among the lowest in the world, are competitive at under US$0.70/hour. In addition, it is important to note that in typical labor-intensive IFZ industries such as apparel -- which comprises 70 percent of Caribbean Basin IFZ activity -- non-cost factors such as the availability of quotas plays a large role in locational decisions. As such, this is a strong advantage for Cape Verde.

9.04 Industrial labor rates, although competitive, appear to be somewhat higher than expected given the country's unemployment. This situation is exacerbated by the high fringe benefit rates.[2] The level of prevailing wages may partly be a reflection of the dominance of

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1 It should be emphasized that water and electricity costs comprise only a small percentage of total IFZ firm operating costs and are thus less important than labor, which typically comprises a much larger portion of operating costs.

2 For example, as discussed in Chapter V, the typical four-week vacation period is double that found in most IFZ-host countries.

state-owned enterprises in Cape Verde, which are buffeted to some degree from the realities of the market place, and can thus offer higher wages than would otherwise be expected. As a result, the gap between public works/agricultural wages with those of industrial concerns is greater than normal. The question remains as to whether Cape Verdeans will accept industrial work below the CVE5,000/month level at which point wages become very competitive. The large number of workers doing labor for CVE150/day (CVE3,250/month), would seem to indicate that workers could readily be found at these rates, particularly given the better work conditions found in a typical IFZ factory. Still, interviewees commonly believed that Cape Verdeans expect at least CVE6,000/month for industrial labor.

9.05 Transportation is a serious bottleneck. Despite continuing references to Cape Verde's geo-strategic location astride Atlantic shipping routes, Cape Verde is currently not well connected to any transport routes. Moreover, with increasing demand and capacity for non-stop flights, there is less reason for airplanes to stopover in Cape Verde.

9.06 Surface transport, which is how most free zone goods are transported, is available on a relatively frequent basis only to Europe, though even these schedules are not regular. Air freight to Europe is hampered by the obstacles faced by exporters based in the industrial centers of Mindelo and Praia on shipments to Sal. The expected reopening of flights between New York/Sal/Johannesburg would facilitate movement to/from North America.

9.07 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 Cape Verde as such operations seldom locate in newly established free zone countries; moreover, the movement of electronics firms offshore is slowing.

9.08 Cape Verde is most likely to attract firms in traditional IFZ sectors. This will include garment assembly, footwear, and other sewn goods. This is because these firms are in extremely cost-conscious industries and require few labor skills and little capital. Moreover, they are subject to tight quotas which restrict expansion opportunities in established production centers. Consequently, they are more willing to experiment with new locations. With its transport constraints, Cape Verde has much more potential in attracting companies producing less time-sensitive products such as uniforms, work gloves and other items less prone to abrupt swings in fashion, that can utilize sea freight.

9.09 Perhaps Cape Verde's strongest business climate advantages are those that are non-quantifiable: the quality of life, the lack of corruption, and general level of safety and political stability cannot be readily measured, but are critical nonetheless to foreign investors.

2. IFZ/Industrial Estate Sites

9.10 One of the major obstacles facing any potential investor in Cape Verde is the absence of suitable industrial facilities. At present, a new investor would have to go through the difficult process of selecting and requesting a location from the municipality, constructing or contracting out the construction of the facility, obtaining utility hook-ups, and then providing on-going security and maintenance for the facility. Because of the difficulties of this process for foreign investors, the existence of a fully-serviced industrial estate has been an attractive option to investors in many countries and construction of such an industrial estate with fully-serviced standard factory buildings for rent is the most effective means of overcoming this constraint in Cape Verde. With recognition of this need, a number of potential industrial estate sites were examined.

9.11 The Achada Grande area in Praia is a viable site for an industrial estate. It is well positioned in terms of the airport, which should be particularly advantageous following the completion of the new facilities and, presumably, direct air service to Portugal. It is large enough to generate economies of scale. Moreover, it requires little earthwork and provides an excellent base for construction. Discussions with Praia water authority management also indicate -- contrary to the perceptions of some -- that expanding capacity over the next two years precludes the need for a desalinization plant for the area, a capital cost that would have likely made the project economically unfeasible. The European Community, as part of its upcoming five-year assistance program to Cape Verde, is expected to finance the infrastructure for this industrial zone, though it is not now envisaged as a fully-serviced, industrial estate with standard factory buildings available for lease.

9.12 Given the stronger private sector presence in Mindelo, superior port, and apparent preference for Mindelo locations by foreign investors, an industrial estate would seem to have a greater chance for success in Sao Vicente. However, each of the three proposed industrial sites in the Mindelo area have important weaknesses. The Zona Industrial Sul is too small for private development, and is already largely occupied. The proposed Lazareto industrial zone, has adequate room for expansion, but is limited by severe gradients and potential drainage problems. The Ribiera de Juliao industrial zone has the advantages of being the easiest to connect to infrastructure, adequate size, and has already undergone planning which would allow it to be implemented quicker. However, this area has squatter developments and is reportedly subject to some of the worst drainage problems in Mindelo.

9.13 The island of Sal, which has the best air connections, is hampered by other factors. With a population of only 10,000 and virtually full employment, it lacks a sufficient base for industrial estate activity. In addition, wage rates in Sal are as much as 40-45 percent higher and labor -- especially for a firm seeking to hire 100 or more workers -- is not readily available. This is not to say that the island would not be appropriate for certain industrial activities on a single-factory free zone basis, as is presently allowed under the industrial development and entrepot framework, but the island is clearly inappropriate for concentrated industrial estate development at this time.

3. Legal, Regulatory, and Institutional Factors

9.14 The present legislative package in Cape Verde is competitive with other IFZ countries and provides a firm legal foundation for export promotion. The duty-free importation and exportation of goods, materials, and equipment as well as the ten-year exemption on income and complementary taxes are competitive with other existing and emerging IFZ programs. Moreover, the ability to hold foreign exchange accounts, register via a 30-day default mechanism, and establish anywhere within the country are also critical elements needed to be competitive. As such, the existing laws already include the necessary elements for an emerging IFZ program. Significantly, the framework also provides incentives to partial exporters, which gives investors in Cape Verde added flexibility.

9.15 From an administrative perspective, importers have noted that a significant improvement in Customs operations is already evident in the past few weeks as a result of new internal Customs regulations. The bureaucratic requirements have been reduced and the time needed for accessing imports has been halved according to some importers. Customs operates on a paper control rather than a physical control basis; this should allow for improved Customs service for firms operating as single-factory free zones and will also allow for an industrial estate to contain both exporting and non-exporting firms, as is the practice in Costa Rica, Mexico, Barbados, Mauritius, and elsewhere. This dual market will improve the chances for financial success for a private industrial estate.

9.16 Institutionally, the existence of PROMEX has the potential to effectively shape both the Cape Verdean legal/regulatory environment as well as assume effective promotion of the country. Institutions of a similar nature -- when organized, staffed, and managed properly -- have had a positive impact on the development of export-oriented programs throughout Central America and the Caribbean.

4. Relationship to Current GOCV Policies

9.17 On an overall basis, it is significant that the new government is more sympathetic to local and external private sectors and is actively working to reduce the administrative and regulatory constraints on Cape Verde's economic potential. Given the government's commitment to follow both import-substitution and export-oriented policies simultaneously, an IFZ program is the best option for balancing these two divergent policies.[3]

9.18 The new government's program includes development of an industrial estate. Discussions with high-level government and municipal officials have indicated a strong desire and preference for the private sector development and management of industrial estates in Cape

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[3] However, in undertaking this dual approach, the GOCV will make it more difficult for backward linkages to be established and, consequently will reinforce the enclave nature of an IFZ program.

Verde. Private sector zones have tended to outperform their public sector counterparts within the Caribbean Basin, and are typically preferred by foreign investors. The implementing regulations for the Industrial Statute have specified that an industrial zone developer would receive the same benefits as any other IFZ or partial exporting firm. Officials have also noted that as with tourism projects, the government is quite open to allow for the private provision of infrastructure on industrial estates. The Minister of Economy has stated that if the private sector is unable to provide for the infrastructure, the government would provide it, either as a minority joint venture partner or as a public service.

9.19 It should be noted that a major Cape Verdean construction firm has strong interest in developing and managing a private industrial estate and has already made inquiries to appropriate government and municipal officials for land allocations. If private sector interest can be mobilized, this would be the preferred mode of industrial estate development and is consistent with GOCV policy and IFZ experience worldwide.

B. OUTLOOK FOR THE FUTURE

9.20 The large number of investors that have visited Cape Verde in the past few years shows potential interest in investing there. The anecdotal reports that 20 investors would have established operations within the archipelago are also positive, even if inflated by half. The Portuguese perception of Cape Verde as a gateway to Africa (despite the vagaries of those markets) is an advantage as well.

9.21 At this juncture, Cape Verde is placed in a vicious circle. It does not have the critical mass required to have highly competitive sea freight rates or regular shipping schedules needed to attract many foreign investors; of course, this situation can only be dramatically transformed by the foreign investors' presence. Cape Verde is not alone in this problem. The IFZ programs in the Dominican Republic and Costa Rica faced a similar situation. In fact, these two countries -- which are now widely considered success stories in IFZ development -- each attracted only five firms in the first four years of their respective programs.

9.22 Cape Verde can expect only modest success with an IFZ program. Cape Verde, at least in the short- to medium-term, is not likely to replicate the IFZ achievements of the Dominican Republic, Mauritius, or Taiwan. Without the benefit of a market study of likely investors, it is difficult to estimate the country's expected investment. The disappointing performance of the country in attracting new investment -- particularly in the export sector -- is evidence of the constraints Cape Verde faces. Weighing the comparative advantages and disadvantages of Cape Verde, an IFZ program could be a modest success and attract 5-15 firms over the next 3-5 years. Discussions with GOCV officials state that given Cape Verde's small size and limited options, this level of new activity would be considered a success. Using an average of 100 workers per factory, an employment generation of 500-1,500 jobs could be generated, leading to foreign exchange earnings of roughly US$1-3 million and an increase of exports by roughly US$2.5-7.5 million.

9.23 Because of the small size of the Cape Verdean economy, the small relative and absolute size of the export sector and the small relative and absolute size of the industrial sector, the definition of success is correspondingly modest in absolute terms. With a base of US$1.4 million in 1986 for the production of "Transformative Industry," and a base of US$3.4 million in 1988 for exports of goods, an industrial free zone program that attracted 5-15 investors would represent a substantial increase over current levels.

9.24 Europe will be the principal market in the near term. Both as a source of potential investors, and as an export market Europe will be the location for Cape Verde. To date, the most important indicator for potential investors was a Lusophone connection. The most recent list of potential foreign investors provided by the Ministry of Industry shows that fifteen of twenty-three recent foreign investment inquiries came from Portugal, with Brazil, Angola and Macau providing significant interest. The next most likely origin for investor interest was other European countries than Portugal. This European interest was no doubt influenced by transportation connections which make Europe the easiest to reach export market.

9.25 The combination of the best transport connections, preferential market access, absolute size of the market, and investor interest make Europe the most likely export market. To the extent that surface and air transport improve, the United States could become a secondary market.

9.26 The prospects for regional trade are limited. While a number of persons interviewed by the consultants voiced the opinion that Cape Verde's geographical position was an advantage, 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.

9.27 Furthermore, many of the basic items (such as paint, soap, clothing) that Cape Verde currently produces are also produced in these other countries, thus effectively depriving Cape Verde 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 ECOWAS countries makes this process more difficult.

9.28 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. 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 market limitations extremely difficult. For these reasons, Cape Verde should look toward Europe as its natural market.

C. RECOMMENDATIONS TO STIMULATE CAPE VERDEAN INDUSTRIAL EXPORTS

9.29 There are a number of areas where the GOCV can implement improvements -- or avoid pitfalls -- that would improve the country's export potential. Given the fact that Cape Verde has only modest potential for industrial free zone development, the recommendations have been designed to reflect a least cost approach for the GOCV. Consequently, it is recommended that no new bureaucracy should be created, the existing legislative package should be revised rather than revamped, and the private sector should be utilized to the fullest degree possible in industrial estate development.

1. Factors of Production

9.30 To maintain or improve Cape Verde's factors of production competitiveness, the following recommendations are appropriate:

- The GOCV should not establish a minimum wage rate. There is some discussion that a minimum wage could be established in Cape Verde. Department of Labor officials feel that workers are generally underpaid. However, historical experience with minimum wages demonstrates that the creation -- or augmentation -- of a minimum wage tends to have a severely negative impact on job creation, particularly at the less skilled levels where unemployment problems are greatest. Given the fact that further increases in Cape Verde's labor rates would largely reduce the country's primary advantage (availability of inexpensive labor), it is strongly recommended that a minimum wage not be enacted.

- Allow open competition in telecommunications. At present, Cape Verde has no overwhelming comparative advantages. By allowing for private sector competition in telecommunications, Cape Verde would have an uncommon advantage. The installation of teleport facilities for an industrial estate would prove attractive for enterprises who would benefit from higher quality international service at prices up to 80 percent below existing rates. The continued improvement of teleport technology makes this option a relatively low-cost and easy to implement alternative. Given the high level support this idea has attracted, it seems likely that the regulatory problems typically encountered in establishing a private telecommunications network would be limited. In addition, a teleport facility is especially appropriate at this time, given Cape Verde's decision to develop an offshore financial services sector. For these reasons, the area of telecommunications is perhaps the easiest of Cape Verde's obstacles to solve.

- Improve air freight and passenger service. Given Cape Verde's remote location and the critical importance of air transport for both internal and external routes, TACV requires substantial transformation to improve its performance. The planned restructuring of TACV will hopefully improve the current level of freight

service from both Mindelo and Praia to Sal. It is essential that TACV's future plans give greater consideration to the importance of air freight service. A higher level of service is also needed for business travelers going to and from Cape Verde. As such, TACV should adhere to schedules, accept credit cards, start business class service, and cultivate a multi-lingual, business-like staff. As a medium- or long-term goal, the GOCV needs to improve the Mindelo airport so that it can service larger, international planes.

- Form a transportation users group. Central American countries -- which once suffered from the same irregular maritime freight service which currently exists in Cape Verde -- were able to improve the scheduling of service and freight costs through the formation of a transportation users group. This group worked closely with relevant shipping agencies to improve service provision until these countries reached the critical mass of containerized exports that they now have.

- Establish market-oriented land prices. The municipalities of Praia and Mindelo are now considering the sales of land to interested parties. This action is positive and gives investors an added option to the current practice of long-term leases. However the land prices currently being discussed by the municipality of Praia are unrealistic, and far above the cost of land available in other developing countries. The maximization of revenue for the municipality should not be the primary objective of the municipality in this matter. Instead, it should be viewed as a privatization of state resources as a means of maximizing their economic potential.

2. IFZ/Industrial Estate Sites

9.31 The establishment of an industrial estate is the most expensive item in the creation of IFZ programs. Because of Cape Verde's modest potential for success in this sector, the recommendations below are made to minimize the GOCV's financial commitment.

9.32 At the present time, Cape Verde is in the fortunate position of having financing committed for an industrial zone (though not a fully-serviced industrial estate) at Achada Grande. From meetings with officials from the Ministry of Public Works and the Department of Industry, it is evident that no adequate market study has been conducted to determine whether in fact the Achada Grande project is viable, or whether an alternative project in Mindelo would have more potential. As such, it is recommended that:

- A feasibility analysis be conducted for an industrial estate project in Cape Verde, based on the findings of a comprehensive market analysis. Based on the market analysis, the optimal industrial estate location will be selected. Market surveys of this type have proven to be effective measures of potential investment in industrial estates and could prevent large mis-use of resources should no demand

exist. Annex C of this report presents an in-depth Terms of Reference for the feasibility study of an industrial estate. This study will include a market analysis, a master plan for the final selected site, environmental impact,[4] and an economic and financial analysis of the proposed estate. The completion of this study will allow the GOCV or interested private sector development groups to then approach private and/or international aid sources for project finance. Combined with the promotional, training, and technical assistance projects of USAID and UNCTAD, the industrial estate project can help Cape Verde develop an alternative export-oriented development path.

- The GOCV should evaluate the costs and benefits of an industrial estate versus other opportunities available. This report has briefly outlined the employment benefits that could be expected from an IFZ program (the economic costs and benefits will be further detailed in the feasibility study). Because the legal and regulatory foundation for the program already exist (with seven sets of implementing regulations remaining to be finalized), this portion of the work has already been completed. However, should the government proceed with the furnishing of infrastructure in Mindelo, for example, the government (or municipality) should examine the costs and benefits of this project vis-a-vis those with perhaps higher economic rates of return such as tourism and fisheries. This will allow the GOCV to more effectively manage its scarce human and financial resources.

9.33 If the market analysis is positive, and one (or two) industrial estate(s) prove(s) to be both financially and economically viable, the GOCV can then proceed through the following steps. Should the market analysis conclude that an industrial estate in Praia has less potential than a site in Mindelo, and the market can justify only one project, then the GOCV could leave the Achada Grande area as an industrial zone and encourage the development of an industrial estate only in Mindelo.

- Establish a general purpose industrial estate. Given the relatively limited potential for attracting export-oriented industries and the poor level of infrastructure in general, it is essential that industrial estates in Cape Verde also be open to import-substitution and commercial warehouse activities. This combination will enlarge the estate's potential market and thus give it a much better chance at attaining financial viability.

- Rely on the private sector, rather than the GOCV, to develop and manage the industrial estate. The government should encourage projects that are completely

[4] Although IFZ firms are typically non-polluting (being primarily assembly operations), an examination of the environmental impact of a proposed industrial estate is still essential given Cape Verde's reliance on fisheries and tourism.

financed by the private sector. The GOCV should encourage and facilitate the installation of private infrastructure for the site, thus further reducing government finance requirements. If the private sector developer is unable to provide all infrastructure needs, the GOCV equity contribution to the project should be limited to the value of the land and the cost of the infrastructure.

- Industrial estate development should be undertaken in a phased, modular approach. If the GOCV -- contrary to these recommendations -- decides to develop and operate an industrial estate itself, it is essential that it not overbuild and utilize a phased, modular plan for future growth. Overly ambitious expansion plans have financially strained industrial estate projects in Guatemala and Liberia, giving them extremely long payback periods.

- Determine the optimal industrial estate location on Sao Vicente. Given that the EC is proceeding with the development of the Achada Grande industrial zone, efforts should also be made by the municipality of Mindelo to ensure that the industrial zones of Ribeira de Juliao or Lazareto offer the best potential for Sao Vicente. Both sites have some shortcomings, and a better site may be possible elsewhere. Mindelo's hilly topography and drainage problems may make it impossible to find a site of sufficient size meeting all desired characteristics. However, this effort deserves further exploration.

- Reserve the Achada Grande area for industrial zone development. Despite the fact that the EC has committed funding for the industrial development of this site, officials within the Municipality of Praia apparently have reservations about using the site for industrial activity, believing the site is more appropriate for housing. Because of the overall outstanding characteristics of this site -- proximity to the port and airport, level terrain, room for expansion -- and the fact that the EC has already conducted a study and committed financing for the project, it would be counterproductive to remove this area from future industrial activity.

- Coordination for an industrial estate project should be done by PROMEX. This is a legitimate function of PROMEX given the fact that it represents both private and public sectors and is consistent with the broad recommendation to utilize existing institutions. PROMEX should serve as contact point for the undertaking of the feasibility study and serve as an interface with relevant ministries, municipalities, utility providers, and the private sector. If and when development of an industrial estate occurs, PROMEX should -- in conjunction with the private developer -- take the lead role to ensure that all of the necessary elements are implemented in a quick and efficient fashion.

3. Legal, Regulatory, and Institutional Factors

9.34 As discussed in Chapter VII, the legal and regulatory foundation for an IFZ-like program already exists in Cape Verde. Consequently, future short-term policy action is reduced. Nonetheless, the following items would be beneficial:

- Modify, rather than revamp, the existing legislative package. Some minor changes are needed in the present legislation including equal treatment for all investors and the ability to pay local debts or expenses in escudos if the firm has earned escudos from GOCV-approved local sales. While the diffusion of the legislative package is less than ideal, it should not prevent the attraction of investors if properly packaged and promoted as "Cape Verde's Free Zone Program." The Dominican Republic had a similarly diffuse IFZ regime for 20 years, and did not unify the legislation until 1990. In the medium-term, the GOCV may want to undertake a similar unification, but given Cape Verde's past delays in drafting and enacting legislation, the existing framework is more than sufficient to eliminate the need for substantial restructuring.

- Finalize the remaining implementing regulations. While the export laws and statutes provide a sound foundation, it is necessary that the government accelerate the finalization of the remaining implementing regulations. After one and a half years, seven of the 13 implementing regulations have yet to be completed, although they are reportedly in draft form.

- Establish no new bureaucracy to implement the incentive package or industrial estate. The legislative framework provides a sufficient basis for implementation and no new bureaucracy is necessary. Similarly, given the GOCV's intention to allow the private sector to take a lead role in industrial estate development, no additional bureaucracy will be required to develop and manage these projects.

- Revise the Labor Code. A revision of the labor code should also be enacted, with modifications that will continue to protect workers' rights while at the same time allowing businesses the flexibility needed to operate efficiently. If reform of the labor code is politically impossible, a second-best alternative is to allow export enterprises this required level of flexibility -- particularly concerning dismissal of non-productive workers, through an amendment to the Industrial Development Statute or other decree exempting them from the more onerous provisions of the Labor Code.

- Modify land-holding policies. As municipalities restructure their landholding policies, they should include a clause that would allow industrial estate developers operating under a long-term lease the right to sub-lease both land and/or buildings. At the present time, only the latter is allowed; however, some IFZ tenants prefer to construct their own buildings.

- Accelerate Customs procedures. Although Customs operations have improved tremendously in recent weeks, the clearance of goods still takes anywhere from two to seven days. To be competitive with other offshore manufacturing centers, Customs must reduce clearance time below 24 hours.

- Do not establish a preferential exchange rate for exporters. An idea that is apparently being considered seriously at the present time is whether the government should establish a dual exchange rate for exporters. Generally, the introduction of a dual exchange rate is done in countries with drastically overvalued currencies, as a means of providing a short-term solution to a highly unpopular, but necessary, devaluation. The parallel market in Cape Verde gives no evidence that this is the case. The establishment of dual exchange rate in Cape Verde, would therefore erode one of the country's historical advantages, a sound and conservative approach to monetary management. The relatively high factor costs, as was discussed in terms of industrial labor rates, is likely more connected to inefficient public monopolies than to an overvalued exchange rate.

- Appoint PROMEX's Coordinating Council as soon as possible. The method of how these Board members will be selected is not specified in PROMEX's by-laws. However, as PROMEX "exercises its action under the oversight of the Prime Minister," lacking any further specification the Board members might be appointed by the Prime Minister. Possible private sector members include the two commercial associations, the industrial association (presently being formed), Customs brokers association (presently being formed), and the bar association.[5] It is critical that these appointments be made, as the Coordinating Council is specifically required to approve the list of personnel and salaries, as well as reviewing the plan of action and the budget. By naming the Council at this time, the private sector can be brought into the planning process and play a role in staffing decisions. Otherwise, the private sector is likely to remain suspicious of any staffing or planning decisions.

- PROMEX should limit its size to a manageable level during its start-up period. As originally envisaged, PROMEX was to have a staff of 10-12, a typical size for a start-up organization of this type. At present, PROMEX's staff could number as many as 31 people, as many as found in the Investment Promotion Council (IPC) in the Dominican Republic -- a country of seven million people and 140,000 workers employed in IFZ firms. In parallel fashion, it should be noted that the IPC had only 10 staff members after its first year of operation while CINDE -- in Costa Rica -- started with 12 employees.

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5 At least one third of the members of the 11-15 member Coordinating Council are to represent the private sector according to the by-laws.

9.35 Although tourism, fisheries, and offshore financial services offer other alternatives to generate foreign exchange earnings and employment opportunities in Cape Verde, the IFZ concept provides it with its only real option to industrialize. While Cape Verde may be able to attract a handful of other import-substitution firms, the small internal market will prevent the creation of any substantial amount of activity even in this sector. In contrast, IFZ programs have demonstrated the ability (given competitive factors, proper design and implementation) to enable small, remote island nations such as Mauritius and Fiji to enter the global industrial marketplace. As such, even with the existing constraints, Cape Verde should proceed with this approach.

ANNEX A
INTERVIEWS CONDUCTED

A. GOCV AND PUBLIC SECTOR OFFICIALS

Ministry of Economy, Transport and Communications

Manuel Casimiro de Jesus Chantre, Minister
Jorge Borges, General Director, Department of Industry
Amilcar Lima, Regional Director, Department of Industry
Jose Mouta, Industrial Promotion Expert, Department of Industry
Christina Duarte, National Director of Export Development Project (UNCTAD), Department of Commerce
Aguinaldo de Almeida Marcal, Technician, Department of Commerce

Ministry of Finance and Planning

Jose Tomas Whanon de Carvalho Veiga, Minister
Manuel Varela Neves, Director General of Planning

Bank of Cape Verde

Sergio C. Centeio, Administrator

Customs

Antonio Omar Lima, Director General
Daniel Sousa, Studies and Planning

Ministry of Foreign Affairs and Cooperation

Jose Luis Jesus, Ambassador to the UN

Department of Labor

Francisco Monteiro, Director General
Artur Tavares

Ministry of Public Works

Eunice Silva
Luis Lopes da Silva

Municipality of Mindelo

Martinho Cristogomo Ramos, Delegado
Marina Bogunova Baptista, Architect

Municipality of Praia

Pedro Bettencourt, Director of Urbanism

Municipality of Sal

Jose Teixeira de Azevedo, Delegado

B. PARASTATAL COMPANIES

ENAPOR

Lucas Santos, General Manager
Franklim do R. Spencer, Director

ENACOL

Rui Spencer Lopes dos Santos, Director General
Orlando V. Freitas, Supply Manager

ASA

Jorge Lima Delgado Lopes, Director General

TACV

Daniel R. Livramento, General Manager (former)
Armindo Sousa, Financial Director

ELECTRA

Sonia Morais, Commercial Director
Daniel Graca

CAAP

Daniel Alexandre Delgado Horta, Director

CTT

Antonio Lobo, Director General

EMPA

Octavio Costa Silva, Director of Imports/Exports
Ida Duarte, Director of External Trade

C. PRIVATE SECTOR REPRESENTATIVES

SOCAL

Pedro Gomes de Matos, Director General
Lazaro Brito da Graca, Commercial Director

Companhia dos Tabacos de Cabo Verde

Antonio Cardoso Santos, General Manager

Confeccoes Morabeza

Cesario Joao Gomes Lopes, Managing Director

Pedro A. Duarte Almeida, Lda.

Pedro Sousa Almeida, President

Shell Cabo Verde

Antonio Canuto, Administrator

Fabrica Favorita

Manuel Brandao Leite, President

Barlavento Commercial, Industrial, and Agricultural Assn.

Edmund C. St. Aubyn S. Carvalho, President

Companhia de Navegacao Estrela Negra

Mr. Gomes

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Pedreira de Salgadinho

Barbara Boeyrens

CABNAVE

Leonildo Monteiro, Executive Administrator

CENTROTEL

J.A. Monteiro Pereira, Managing Director

Nascimento Tuna

Sotavento Commercial and Agricultural Association

Carlos Leopoldino de Almeida
Alfredo Eugenio Barbosa Fernandes

Veiga Customs Brokers

Emmanuel Veiga

Doci/Pica Pau

Carlos Jorge M. de Vasconcelos

CERIS

Erik Kaas Petersen, Director General

Empreitel Figueiredo

Alexandre H. Figueiredo Silva, Director General

TAP

Eduardo C.E.A. Nascimento, General Manager, Cape Verde

SEAGE

Cesar Semedo, Administrator

INFARMA/EMPROFAC

Judith Lima, Director General

SITA

Manuel Setembrino, Director General

D. OTHER INDIVIDUALS/ORGANIZATIONS

USAID

Tom Luche, Mission Director
John Jones, General Development Officer
Jose Goncalves, EDS Project Administrator
Meg Glasston, Training Officer

PROMEX

Jose Luis Fernandes Lopes, President
Gunnar Sjogren, Special Assistant to the President

ETC Foundation

Lucien Beck, Consultant

Others

Adao Rocha, former Minister of Industry
Antonio E. Evora, Economist
Mr. Rui de Melo Araujo, Lawyer

E. MEETINGS OUTSIDE CAPE VERDE

Embassy of Cape Verde

Klaus May, Consultant

INITIUM

Jose Luis Almeida Pinheiro, Economist

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Cape Verde Warehouse

Manuel Medina

U.S.-Cape Verde Business and Trade Council

Lisa Audet

World Bank

Michel Loir

Universal Shipping

Ray Hoelhe
Bob Powell

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ANNEX B
DESIGN AND INFRASTRUCTURE CONSIDERATIONS

In order for the GOCV, the municipalities, public service providers, and the private sector to better coordinate the planning and construction of industrial estates, the following design and infrastructure criteria have been included.

Design Considerations

Increasing competition among IFZ locations has necessitated careful and comprehensive design of facilities and physical amenities to specifically target the needs and requirements of light industry and export manufacturers. Experience has demonstrated that successful project development is linked to the responsiveness of IFZ management to existing and potential zone firms' needs.

In many developing country business climates, suitable manufacturing space is in high demand, and the development of IFZ facilities offering simple factory shells and basic services as an assured success. Such an assumption is short-sighted. By investigating the demands of potential tenants, a zone developer can minimize costs and avoid the expense and inconvenience of reconfiguring structures and services at a later date.

Although the 1980s have witnessed a burgeoning number of innovative IFZ initiatives such as information industry IFZs and office park-style zones, most IFZs are functional industrial areas. As such, they are generally comprised of standard industrial plots, with facilities erected according to accepted industrial real estate land-use ratios and international design standards.

The principal users of IFZs around the world have traditionally been firms engaged in light manufacturing -- apparel, electronics, footwear, toys and sporting goods, and other light manufacturing industries. These firms, as a group, have certain facilities and service requirements. The consultants have outlined the following guidelines for the design of the project, with the proviso that these standards can be adapted to meet Cape Verdean conditions and practices when advisable or necessary.

Layout. In general, industrial analysts place the lower limit for cost-effective zone development at 10 ha. This size is adequate to achieve economies of scale without exposing the project to initial capital outlays that would later compromise the zone financially. The size of each phase of zone development depends primarily on the level of demand that has been evidenced for the project, although the financial resources of the developer will necessarily also influence the speed of development. In most cases, it is desirable to finance land preparation and

development in phases of at least 4 ha. in size so that some economies of scale can be achieved with regards to construction costs.[1]

In any industrial estate, the determination of efficient land use requires arriving at an acceptable compromise between maximizing the project's rentable space without introducing detrimental effects to the zone's operations and overall appearance. The master plan (a preliminary architectural/engineering document used to develop design and construction plans) for the site should allow for some degree of flexibility in plot layout, providing for a spacious, aesthetically attractive configuration. Approximately 75 percent of the zone's total area should be devoted to industrial plots, with the remaining 25 percent for roads, administration, utility easements, green areas, and any other non-revenue producing areas needed. Of the area allocated to industrial plots, 30-50 percent of the space should be utilized for actual factory space. It is important that a balance be met here, as overbuilding can result in congestion and decrease the overall efficiency of zone operations. On the other hand, overly generous building/plot ratios can substantially reduce the financial viability of the project.

While slightly sloping land is preferable to one that is completely level, land with a gradient of more than 6-8 percent should be avoided due to higher land preparation costs. Naturally, sites should have access to good transportation and land should not be particularly susceptible to drainage problems, earthquakes, etc.

The proposed site design should follow the natural contours of the land to maximize aesthetic appeal. The creation of an attractive environment through landscaping, signage, etc. can be effective amenities in attracting tenants.

SFB Design. In order to accomodate the diverse activities of small- to medium-size light manufacturers, zone management should provide easily alterable facilities. Zone facilities must strive to relieve the investor of the time-consuming and costly process of acquiring land, planning and constructing facilities, and obtaining utility hook-ups. Investors in the sectors normally interested in IFZ production have historically shown a clear preference for fully serviced standard factory shells with easy partitioning, subdivision, and expansion as needed. Typical IFZ standard factory buildings (SFB) range in size from 500-5,000 sq.m. When the SFBs are of greater dimension, the zone developer can either rent the space to a single user or divide the space for multiple tenants. In zone projects where demand is uncertain, a medium-size building of 1,000-2,000 sq.m. is usually the best option.

The SFB should follow local standards in terms of design and construction materials used. It is important that the design be applicable for most light industries. The clear height to truss should be approximately 5-6 meters with a reinforced concrete floor. The design should utilize standard local practices in terms of footings, foundation and ventilation. The ability to allow for the

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[1] In balancing the construction schedule with demand figures, a reasonable surplus of unallocated factory space and developed land (10-15 percent) should be available at all times. The prospect of immediate occupancy has proven to be an exceptionally effective promotion tool in zone programs worldwide.

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installation of a second floor is a useful feature in some countries where there is a lack of available land, but adds to construction cost and may not be needed in many cases.

Approximately 5 percent of the total SFB space should be devoted to walled-in office space. Sanitary facilities must be provided, with approximately 75 percent allocation for females as IFZ employment is usually biased in favor of women. The provision of showers is typically unnecessary. Though not a common Cape Verdean practice, space for a small canteen could be reserved.

Fencing. One possible specification for fencing is a 2.5-3 meter high fence topped with two or three rows of barbed wire, which should be installed around the first phase of the project. For economic reasons, it is often advisable to utilize a chain link fence.

Roads. A 7-8 meter wide road should be utilized in the first phase and space should be allocated to double the width of this road near the entrance of the zone at a later date. Sufficient space should be allocated to allow for truck turnaround. In addition, space should also be set aside to extend the roads into later phases of development.

Parking. As most workers will commute by bus, it will be advisable to provide a bus terminal for 2-3 buses just outside the zone. This outside placement is necessary to reduce the amount of traffic and congestion within the IFZ. A separate entrance should then be designed for workers arriving on foot or by mass transportation. A small number of parking spaces should be allocated for employees with their own vehicles. In addition, a common parking area near the gate and administrative buildings wold be convenient for zone management and visitors. On-street parking should not be allowed.

Administrative and Other Buildings. An administrative building for a staff of 4-6 managerial/professional personnel and support office workers is generally located near the entrance of the zone. This building could be comprised of two floors and designed in a manner to be expanded as the zone itself grows in size. The building should eventually provide for the following: office space (upstairs), meeting room, display area, medical clinic, locker room for guards and maintenance workers. A small structure should also be provided at the gate for guards and Customs personnel. Lastly, a garage may be needed to house fire fighting equipment.

As the zone increases in size, zone management should consider the provision of day care facilities, a bank, post office and recreation area. However, these expenses may not be financially justifiable in the first phase of development.

Infrastructure

In 10 ha. zone with 7.5 ha. of industrial plots at 40 percent of under-roof coverage will have approximately 30,000 sq.m. of SFB space. It is usually safe to estimate 1 worker per 10 sq.m. of space, thus yielding approximately 3,000 workers (assuming only one shift) in the first phase

of the zone. Assuming that each firm employs 100 workers, this would translate into approximately 30 firms. Using these general guidelines, it is possible to estimate the infrastructure needs provided that all IFZ firms are light assembly manufacturers without special power or water demands.

Water and Sewerage. Light assembly manufacturers typically use water only for sanitary, drinking and maintenance purposes. Water supply of about 35,000-50,000 liters/ha./day is typically recommended IFZ industrial estates. In the case of Cape Verde, this amount will have to be reduced to some degree. The Achada Grande industrial zone study used a figure of 20,000 liters/ha./day. This may be acceptable, assuming careful conservation of water, desert landscaping, and no use of water in production processes. Static water pressure at ground level should be -- at minimum -- 20 pounds per square inch. Given traditional difficulties with water in Cape Verde, a reserve storage tank should be constructed to ensure reliable supply. A waste water treatment facility, whether on- or off-site, should be capable of handling 95 percent of the water capacity; this is particularly important in Cape Verde, as the use of septic tanks makes further use of the water impossible. The provision of fire hydrants should also be included.

Power. On average, each hectare of industrial plot will require up to 250 kw electric power supply; a 10 ha. zone with 7.5 ha. of industrial plots should therefore be provided with 2.0 megawatt load capacity.

Telecommunications. In the past, it was generally recommended that each factory be supplied with a minimum of two telephone lines. However, with the advent of the facsimile machine, it is recommended that each factory be provided with a minimum of three telephone lines. Consequently, the zone would require approximately 100 lines. For both electricity and telecommunications, the government should consider the issue of underground and overhead cables. While underground cables are more expensive, they are safer and contribute to better IFZ appearance.

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ANNEX C
DRAFT TERMS OF REFERENCE
TECHNICAL ASSISTANCE FOR INDUSTRIAL ESTATE/FREE ZONE FEASIBILITY STUDY

The following terms of reference have been drafted to provide a basis for arranging necessary technical assistance to proceed with the next steps for implementation of an industrial free zone program in Cape Verde. These terms of reference are based on the conclusions to the prefeasibility study, and are intended to address the principal remaining areas for investigation and definition.

SCOPE OF WORK

The scope of work outlined here assumes that the GOCV will continue with the implementation of the external investment law and industrial statutes by preparing the remaining decrees, and that other minor steps needed to refine the legal and institutional climate do not require additional technical assistance which otherwise would form a part of this feasibility study; or that such minor short-term technical assistance as may be required is already being pursued under the various mechanisms in place with UNCTAD, USAID funded activities at PROMEX and other bilateral assistance. Therefore, the focus of this TOR is on the further definition of specific industrial estate projects in the form of a full feasibility study, with a concentration on defining and developing the potential market for an IFZ, site selection and evaluation, institutional configuration, and financial and economic analysis.

The EC is already funding preliminary definition of the Achada Grande area as an industrial zone. This plan calls for the installation of infrastructure on the 8 hectare site to support industrial development. Individual firms would then construct their own factory buildings, warehouses, etc. This site could also conceivably be further developed as an IE/IFZ with fully-serviced standard factory buildings (SFB) for lease. The pre-investment analysis conducted to date has not addressed its development as an IE/IFZ, and therefore has not treated a number of elements in the feasibility analysis. Similarly, the other potential projects discussed in the report, which have had lesser degrees of actual planning as industrial zones, also have not been subject to a comprehensive feasibility analysis, particularly as IE/IFZs. As the lack of readily available industrial sites or zones, let alone a fully serviced IE, is a significant deterrent to new investment in industry, this element will be the focus of immediate next steps undertaken by the GOCV to implement an IFZ program.

I. MARKET ANALYSIS

Previous analyses of Cape Verde's industrial potential have not included a comprehensive market analysis, however a substantial amount of information has been developed which will provide the

basis for a definitive assessment of the magnitude, character and critical priorities of high potential firms for investing in Cape Verde. Although many market analyses focus on sectoral targeting and surveys firms in those sectors by either mail, telephone, or direct interview, previous experience with this type of market analysis for African countries embarking on free zone programs indicate an extremely low rate of response. Given Cape Verde's situation, a similar negative response is also likely to a random survey of sectorally targeted firms in the industrial countries, even though such firms may ultimately become investors in the country. Therefore, the market analysis component will focus on a highly targeted sampling of potential firms, many of which have already expressed interest in one form or another in the country.

In the case of Cape Verde, it is likely that the initial investors in export manufacturing will come from a small group of firms with some pre-existing ties to Cape Verde. These firms will most likely be from Portugal or other Lusophone countries, or additionally other European nations.

With this general approach, the market analysis will incorporate the following tasks.

Review of Previous Analyses, Studies and Government Records. The contractor will review previous studies on both commercial and industrial free zone activity for their market analysis components. Additionally, records of existing investor interest will also be compiled from government and other sources.

Definition of High Priority Target Markets. Based on this information, the contractor will assemble a list of high priority contacts. This list may include both types of firms, defined sectorally and geographically, and individual firms. Firms should include industrial operations oriented both to local markets and export, as well as commercial firms requiring warehouse or other facilities.

Survey of high potential firms. Based on the above targeting, the contractor will contact and survey a minimum of 100 high-potential enterprises. Contacts will be administered a standard survey questionnaire which will elicit information concerning their international activities and potential interest in Cape Verde, as well as priorities or requirements for investing in terms of locations, infrastructure, service requirements, other factors of production. (A draft of the questionnaire will be submitted to USAID Cape Verde prior to pilot testing and administration.) No less than 40 of these contacts shall be in-person interviews; the balance may be either administered by mail or telephone or both, depending on the relative efficiency of each. Initial survey samples should be larger than 100 to allow for non-responses. No more than 60 percent of responses should be from Portuguese firms.

Analysis of Survey Data. The results of the survey shall be analyzed to determine the likely demand from investors for industrial facilities, the preference for potential sites within the country, specific infrastructure, facility, or service requirements, and other factors determining the magnitude and nature of demand for industrial facilities.

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Summary of Market Analysis. Based on the survey results, the primary markets for an industrial estate development in Cape Verde will be defined.

Implications for Investment Promotion. Based on the response of potential investors, the contractor will provide a strategy for investment promotion by PROMEX to target the high potential firms and assist them in making investments in Cape Verde.

II. SITE EVALUATION, PLANNING, AND DEVELOPMENT COST ESTIMATES

A number of potential sites have already been identified for IE/IFZ development. Based on previous analyses, physical site evaluations, and the market analysis in I. above, the contractor will provide an assessment of available sites for IFZ development, select one site as offering the greatest potential from both the market response and the physical characteristics, develop a master plan for development of that site, and estimate the costs of that development. The specific tasks to be conducted include the following.

Assessment of Potential Sites for IFZ development. The contractor will assess the relative advantages and disadvantages of proposed sites for IFZ development. This assessment will include the physical characteristics of the site, the expected costs of development, the infrastructure requirements, and the potential market appeal for the location, with input from the market analysis to be conducted in Phase I.

Selection of Priority Site for Development. Based on the assessment above, the contractor will select one (or two) site(s) for initial development in Cape Verde.

Preparation of Master Plan. For the proposed site, the contractor will prepare a master plan which will detail the overall layout of the site, internal road network, internal infrastructure, requirements for external infrastructure, design of SFBs, and the design of administrative or other facilities which may be required. The plan developed will be in accordance with standard industrial estate design criteria, taking into account local conditions which may warrant special treatment. If appropriate given the physical characteristics of the site and the market analysis, the master plan will show phases of development which will be undertaken in sequence.

Preparation of Development Cost Estimates. Based on the Master Plan, the contractor will provide development cost estimates for the construction of the industrial estate. These estimates will include the cost of the land, the cost of land preparation, internal infrastructure, external infrastructure, and the cost of SFB construction as well as any other facilities called for in the Master Plan. Costs will have a confidence interval of plus or minus 15 percent.

Environmental Impact Assessment. The contractor shall provide an environmental impact assessment of the proposed IFZ development. This assessment shall include an assessment of unique factors of the site which may be lost due to the development, the impact on the local

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ecosystems of the development, disposal and/or treatment of wastes, and remedial measures which can be taken to minimize negative environmental effects.

III. RECOMMEND OPTIMUM ZONE CONFIGURATION: FINANCIAL, OWNERSHIP AND MANAGEMENT STRUCTURE

In the absence of any defined organizational responsibility for industrial estate development, a plan for the optimum allocation of responsibilities among government and the private sector is required. The development of such a plan for IFZ ownership and management should take into account the experience of other countries in IFZ development as well as the resources available domestically in Cape Verde and those which may be able to be mobilized from external resources. The following specific tasks will be performed.

Assessment of Existing Institutional Capabilities. The contractor will investigate all potential resources in Cape Verde for spearheading IFZ development. This assessment will cover public sector and parastatal organizations, including relevant government ministries, port authorities, industrial development agencies, municipal government agencies, etc., as well as private construction firms, and other private firms which may be interested in IFZ development.

Assessment of External Resources. The contractor will provide an assessment of potential external sources of IFZ development expertise, including the potential involvement of foreign commercial organizations, firms and individuals. This assessment will specify the modes of involvement of external involvement in IFZ development.

Identification of Sources of Finance. Given the limited financial resources available for IFZ development in Cape Verde, the contractor will identify potential sources of finance for the project proposed, contact those sources, identify the costs and requirements for accessing those sources, and make preliminary recommendations for financing the zone development.

Recommendation for Optimal IFZ Development Configuration. Based on the above review, the contractor will provide recommendations for the optimal institutional configuration of zone development. This recommendation will include the relative roles of public and private sector organizations, as well as domestic and external organizations.

IV. FINANCIAL AND ECONOMIC ANALYSIS

Based on the information and recommendations of previous tasks, the contractor will undertake a financial and economic analysis for the development of the proposed site. This analysis will include the following elements.

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Development Plan. The development of the proposed site shall be presented in phases, showing the costs for each phase on an annual basis. This shall be developed in accordance with the development cost estimates generated, and shall be consistent with the market analysis.

Income, Operating Cost and Cash Flow Projections. The contractor shall provide a detailed pro forma financial plan to include income projections, pro forma balance sheet, cash flow statements, break even analysis, ratio analysis, etc. for the IFZ, based on the projected rental rate, occupancy rates, and development plan.

Financing Plan. The financing plan will indicate the sources of finance for IFZ development, and the costs associated with financing the zone.

Rate of Return Analysis. The contractor will provide standard calculations of rates of return for the project, to include at a minimum the internal rate of return and the return on equity.

Sensitivity Analsyis. Given the nature of the assumptions in the financial analsyis, the contractor will undertake a sensitivity analysis to test its response to changes in those assumptions. A minimum of five alternative scenarios will be presented.

Economic Analysis. The economic returns to the project will be estimated, making allowance for costs and benefits not adequately reflected in the financial analysis indicated above.

Recommendations. Based on the conclusions of the financial and economic analyses, the contractor will provide recommendations for the successful development and operation of the zone.

LEVEL OF EFFORT ESTIMATES

The following levels of effort, expressed in person-days, are estimated to be required for the execution of the study.

I.	MARKET ANALYSIS	70
II.	SITE EVALUATION, PLANNING, AND COST ESTIMATES (For two sites, if appropriate, 100)	60
III.	FINANCIAL, OWNERSHIP & MANAGEMENT STRUCTURE (For two projects, if appropriate, 25)	20
IV.	FINANCIAL AND ECONOMIC ANALYSIS	25
	TOTAL LEVEL OF EFFORT (For two sites/projects, 220)	175

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PROFESSIONAL REQUIREMENTS

The proposed study requires a breadth of technical expertise in various areas related to industrial estate planning and development. The actual configuration of the team will depend somewhat on the expertise of individuals available, and could be shared among the qualifications listed below in various combinations. At a minimum, the following professional qualifications will be required:

Senior Market Analyst. Experience in the analysis of international investment flows to developing countries, sectoral and geographic targeting of investment promotion efforts, design and administration of investor surveys, and issues relating to foreign investment in Africa and to non-equity modes of production sharing as well. Experience in conducting investor surveys and projection of potential investment flows. Familiarity with U.S., Asian, and European outward processing programs/industries and traditional offshore investment. Familiarity with Cape Verde and Lusophone Africa would be helpful.

Market Analyst. Experience in industrial sector research and analysis. Prior experience in administration of surveys to decisionmakers in private industry. Experience interviewing firms, conduct of investor surveys, and compilation of results. Familiarity with Africa and Cape Verde would be helpful.

Market Research Analyst/Assistant. Experience in business/industrial research, identification of company prospects, administration of surveys/questionnaires and data analysis.

Industrial Estate Planner/Architect. Experience in the design, costing and construction of industrial estates, preferably in developing countries. Experience in overall layout of industrial estates and design of standard factory buildings.

Industrial Estate Engineer. Experience in the costing of industrial facilities and buildings, utilization of alternative construction methods for industrial buildings. Knowledge of Cape Verdean construction capabilities and requirements necessary.

Management Specialist. Experience in development and management of industrial estates; experience in bringing together business groups for development projects; experience in structuring finance packages for industrial projects in developing countries.

Financial and Economic Analyst. Experience in modeling industrial investment projects; financial and economic analysis of industrial projects; financial and analysis of IFZ/IE projects.

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ANNEX D
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