PN-ABH-669
ISN 70921

THE ENABLING ENVIRONMENT FOR KENYAN EXPORT PROCESSING ZONES

FINAL REPORT

Submitted to the Ministry of Finance
of the Republic of Kenya

January 1990

Submitted By

THE SERVICES GROUP
1815 N. Lynn Street, Suite 200
Arlington, Virginia 22209
Telephone: (703) 528-7444
Fax: (703) 522-2329
Telex: 29207 FZAS UR

In Association With

MWANIKI ASSOCIATES LTD.
Nairobi, Kenya

and

SRI INTERNATIONAL
Arlington, Virginia

THE ENABLING ENVIRONMENT FOR KENYAN EXPORT PROCESSING ZONES

FINAL REPORT

Submitted to the Ministry of Finance
of the Republic of Kenya

006365
006141
002851

January 1990

Submitted By

THE SERVICES GROUP
Arlington, Virginia

In Association With

MWANIKI ASSOCIATES LTD.
Nairobi, Kenya

and

SRI INTERNATIONAL
Arlington, Virginia

TABLE OF CONTENTS

	Page
Executive Summary	i
I. INTRODUCTION AND BACKGROUND	1
A. REPORT PURPOSE AND ORGANIZATION	1
1. Purpose	1
2. Technical Approach	2
3. Report Organization	2
B. BACKGROUND AND EVOLUTION OF FREE ZONE CONCEPT	3
1. The Free Zone Concept	3
2. The EPZ Concept	4
II. COMPARATIVE ANALYSIS OF INTERNATIONAL EPZ PROGRAMS	9
A. EVOLUTION OF INTERNATIONAL FREE ZONE ACTIVITY	9
B. COMPARATIVE ANALYSIS OF LEADING EPZ PROGRAMS	12
1. Asian Export Processing Zones	12
2. African/Middle Eastern Export Processing Zones	22
3. Caribbean Basin/Central American Export Processing Zones	32
C. LESSONS LEARNED: GUIDELINES FOR EFFECTIVE EPZ DEVELOPMENT	45
1. EPZ Policy Framework	45
2. Ownership and Management of FPZs	49
3. Administration of the EPZ Package	50
4. Export Processing Zones and Broader Economic Policy Liberalization	51
III. ASSESSMENT OF THE KENYAN ENVIRONMENT FOR EPZ DEVELOPMENT	53
A. ELEMENTS AFFECTING THE COMPETITIVENESS OF A POTENTIAL EPZ LOCATION	53
B. ASSESSMENT OF THE CURRENT MACROECONOMIC CLIMATE	53
C. ASSESSMENT OF BASIC FACTORS OF PRODUCTION	55
1. Labor	55
2. Infrastructure and Basic Services	59
3. Capital	63
4. Land	67
5. Other Factors Influencing Production	71
D. ASSESSMENT OF THE EXISTING REGULATORY/INSTITUTIONAL FRAMEWORK AND PROCEDURES	72
1. Overview	72
2. Assessment of Existing Schemes for Export Processing	74
3. Customs Policies/Procedures	79
4. Investment Approval and Business Formation Policies/Procedures	82
5. Foreign Exchange Regulations and Repatriation of Capital Policies/Procedures	83
6. Land Ownership and Tenancy Policies/Procedures	85
7. Labor Policies/Procedures	87
8. Other Regulations Affecting Foreign and Local Investment	89

E. KENYA'S COMPETITIVENESS AS AN EPZ LOCATION 91
1. Basic Factors of Production 91
2. Institutional and Regulatory Policies 91

IV. EPZ MARKET AND DEMAND ANALYSIS 93
A. ASSESSMENT OF THE END-USER GLOBAL MARKETS FOR EPZ PRODUCTS 93
1. Overview of Key EPZ Export Market Opportunities 93
2. Structure and Trends of End-User Markets 93
3. Preferential Market Access Agreements 107
B. DEMAND ANALYSIS: POTENTIAL INVESTOR RESPONSE TO KENYAN EPZ OPPORTUNITIES 110
1. Global Trends in Offshore Production 112
2. Locational Requirements of Target Industry Sectors for Kenya 114
3. Recent Investment Trends in Kenya 123
C. IMPLICATIONS OF GLOBAL TRENDS AND MARKET ASSESSMENT FOR KENYAN EPZ DEVELOPMENT STRATEGY 124

V. PROPOSED LEGAL AND REGULATORY FRAMEWORK 127
A. OVERVIEW 127
B. PROPOSED ELEMENTS OF THE KENYAN EPZ LEGISLATION 127
1. Basic Principles 127
2. Eligibility for EPZ Status 148
3. Proposed Incentives for EPZ Enterprises 130
C. PROPOSED KENYAN EPZ FOREIGN EXCHANGE AND CUSTOMS PROCEDURES 143

VI. PROPOSED EPZ INSTITUTIONAL AND ADMINISTRATIVE FRAMEWORK 145
A. ALTERNATIVE INSTITUTIONAL MODELS FOR IMPLEMENTATION OF EPZS 145
1. Basic Structure 145
2. Core Functions of EPZ Regulatory Agencies 147
B. THE KENYAN CONTEXT 148
1. GOK Institutions With a Role in the EPZ Program 148
2. Models of Potential Institutional Alternatives in Kenya 150
C. PROPOSED CONFIGURATION OF EPZ REGULATORY BODY 154
1. Structure and Objectives 154
2. Staffing and Functions 156
D. KEY ADMINISTRATIVE PROCEDURES 157
1. Recommended Application Procedures for EPZ User Status 157
2. Recommended Procedures for Free Zone Designation 159

VII. EPZ OWNERSHIP AND MANAGEMENT FRAMEWORK 175
A. ALTERNATIVE OWNERSHIP AND MANAGEMENT CONFIGURATIONS 175
B. ATTRIBUTES OF SUCCESSFUL DEVELOPMENT GROUPS 176
C. EPZ MANAGEMENT 179
D. PRICING OF EPZ FACTORY SPACE AND SERVICES 182
1. Objectives of a Sound Pricing Strategy 182
2. Purchasing Option 184

E. FACILITIES AND SITE REQUIREMENTS 184
F. SUPPORT SERVICES AND AMENITIES 188
G. RECOMMENDATIONS FOR KENYAN EPZ DEVELOPMENT 190

VIII. A. IMPLEMENTATION PLAN 195
B. IMPLEMENTATION OBJECTIVES 198
1. Enact EPZ Legislation and Implementing Regulations 198
2. Establish EPZ Regulatory Authority 198
3. Establish the GOK Institutional Framework 199
4. Designation of EPZ Projects 200
5. Financial Support for EPZ Development 200
6. Activation of EPZ Marketing and Promotional Program 201
7. Integration of the EPZs with the Local Economy 202

ANNEX A: INTERVIEWS CONDUCTED

ANNEX B: PROPOSED KENYAN EPZ PROMOTIONAL STRATEGY

ANNEX C: INSTITUTIONAL ASSESSMENT OF THE CUSTOMS AND EXCISE DEPARTMENT

ANNEX D: MODEL EPZ CUSTOMS PROCEDURES

ANNEX E: MODEL OUTLINE FOR A KENYAN EPZ ACT AND SAMPLE LEGISLATION

SELECTED BIBLIOGRAPHY

LIST OF TABLES AND FIGURES

TABLES

		Page
Table 2-1	Worldwide Growth of Industrial Park-Style Export Processing Zones	9
Table 2-2	Export Processing Zones in Operation Worldwide	10
Table 2-3	Profile of Asian EPZ Programs	13
Table 2-4	Growth of EPZ Export Earnings in Taiwan and Korea	14
Table 2-5	Employment Creation and Export Sales/Job in Taiwanese and Korean EPZs	15
Table 2-6	Evolution of the EPZ Policy Regimes in Taiwan and Korea	18
Table 2-7	Comparison of EPZ Incentives in Taiwan and Korea	19
Table 2-8	Comparison of Export Incentives in Asian Countries	20
Table 2-9	Profile of Operating African/Middle Eastern EPZ Programs	23
Table 2-10	Economic Impact of Mauritian EPZs	24
Table 2-11	Evolution of the EPZ Policy Regime in Mauritius	27
Table 2-12	Comparison of Export Incentives in African and Middle Eastern Countries	30
Table 2-13	Growth of Caribbean/Central American EPZs, 1975-88	33
Table 2-14	Profile of Caribbean/Central American EPZ Programs	33
Table 2-15	Growth of Dominican EPZs	36
Table 2-16	Mexican Maquiladora Historical Statistics	37
Table 2-17	Evolution of the Dominican EPZ Regime	39
Table 2-18	Comparison of Export Incentives in Central American and Caribbean Countries	42
Table 3-1	Comparative Average Monthly Base Wages in Kenya	58
Table 3-2	Comparative Infrastructure Costs	62
Table 4-1	Shares of World Clothing Imports, Selected Countries, 1986	94
Table 4-2	Leading EC Importers of Switchgears and Related Parts, and Major Import Sources	101
Table 4-3	Direct NIC Investment in the New Southeast Asian NICs, 1988	113
Table 4-4	Foreign Direct Investment in Kenya, 1977-88	124
Table 5-1	Comparison of the Manufacturing-Under-Bond Scheme and Proposed EPZ Regime	170
Table 7-1	Comparative SFB Rental Rates, 1989	183

FIGURES

Figure 7-1	Suggested Organizational Structure for EPZ Management	183
Figure 8-1	Implementation Plan	196

ACRONYMS AND ABBREVIATIONS

ACP	African-Caribbean-Pacific
BOT	Build-Operate-Transfer
CAP	Common Agricultural Policy
CIF	Cost in Freight
CMA	Capital Markets Authority
COTU	Central Organization of Trade Unions
CZF	Corporacion de la Zona Franca
DFCK	Development Finance Corporation of Kenya Ltd.
DRC	Domestic Resource Costs
EADB	East African Development Bank
EC	European Community
EC	Export Compensation Scheme
ECA	Exchange Control Act
EIU	Economist Intelligence Unit
EPZ	Export Processing Zone
EPZA	Export Processing Zone Authority
FKE	Federation of Kenyan Employers
FTZ	Free Trade Zone
FX	Foreign Exchange
GOK	Government of Kenya
GSP	Generalized System of Preferences
ICDC	Industrial and Commercial Development Corporation
IDB	Industrial Development Bank Ltd.
IPC	Investment Promotion Centre
IRR	Internal Rate of Return
KAM	Kenyan Association of Manufacturers
KIE	Kenyan Industrial Estates Ltd.
KPTC	Kenyan Post and Telecommunications Corporation
KTDC	Kenyan Tourist Corporation
Ksh	Kenyan shilling
Kwh	Kilowatt hour
LDC	Less Developed Countries
LOI	Level of Interest
MA	Mwaniki Associates
MFA	Multi Fibre Arrangement
MOF	Ministry of Finance
MUB	Manufacturing Under Bond
NBFI	Near Bank Financial Institutions
NIC	Newly Industrialized Countries
OECD	Organization for Economic Cooperation and Development

PTA	Preferential Trade Area
R&D	Research and Development
sq.m.	square meter
sq.ft.	square foot
SRI	SRI International
TA	Technical Assistance Scheme
TSG	The Services Group, Inc.
USAID	U.S. Agency for International Development

US$1.00 = Ksh 21.6
(Average)

EXECUTIVE SUMMARY

Introduction. This report presents the findings of a three-month study, undertaken for the Ministry of Finance of the Government of Kenya with support from the U.S. Agency for International Development, to recommend an optimal Export Processing Zone (EPZ) development strategy for the country. It represents the work of an eight-member team from The Services Group, Mwaniki & Associates, and SRI International.

Background on Export Processing Zones. Export Processing Zone (EPZs) are a relatively recent adaptation of the free trade zone concept, with a demonstrated record of success in many developing countries. They offer export-oriented assembly and manufacturing industries an environment of comprehensive policy liberalization. EPZ incentives may either be restricted to a defined geographic area such as an industrial park or be available to individual export processing companies regardless of location. Within the EPZ boundaries, export industries may import goods from the world market without payment of Customs duties, operate free of normal regulations governing foreign exchange, enjoy no or lowered taxation on profits and dividends, and otherwise avoid problems with red tape and bureaucracy that often restrict export activities.

Physically, most EPZs resemble industrial parks, where industries can be assured of a high standard of infrastructure, support services, and standard factory buildings. Private developers as well as public sector organizations have found they can obtain high rents from zone tenants when competitive zone incentive policies are combined with world-class industrial estate amenities.

An estimated 145 industrial estate-style EPZs are now operational worldwide in 45 countries, employing approximately 1.5 million workers. Taiwan, Korea, Malaysia, and Singapore found EPZs to be crucial in attracting export assembly and manufacturing operations; more than half of Taiwan's net foreign exchange earnings over the past two decades has been generated by three EPZs. Mauritius, in the African region, has reduced its unemployment rate from more than 20 percent to less than four percent since 1983, as the result of rapid growth in its EPZ sector. China, the Soviet Union, and other socialist countries have undertaken or are currently considering EPZ-style initiatives in an effort to modernize their economies, create jobs, and improve foreign exchange earnings. In Africa, countries such as Madagascar, Togo, Cameroon, and Cape Verde recently have also launched aggressive EPZ development initiatives.

The experience of successful EPZ sponsors has demonstrated the critical importance of several elements in zone success. At the national level, an EPZ program must comprehensively remove deterrents to export industry growth -- through reduction or elimination of Customs, tax, and regulatory constraints. In addition, the institution(s) vested with responsibility for administering the EPZ program must demonstrate to an often-skeptical international business community that predictable approvals of incentives are forthcoming for applicant firms. Zone developers, service providers, and user industries should have equal eligibility for the standard incentives package, and locally and foreign-owned firms should be equally treated. At the project (site-specific level), the most successful EPZs tend to be those owned and managed by private sector interests;

zones operated by for-profit firms, in particular, have established a reputation among international investors for high levels of responsiveness to occupant needs. Public sector zones in countries such as Senegal, Liberia, Guatemala, and elsewhere, by contrast, have produced disappointing results despite charging below-market rents to attract users.

Assessment of the Kenyan Environment for EPZ Development. By most indicators, conditions in the Kenyan economy appear conducive to EPZ success. The record of political stability, the historic private sector orientation of government policy, and the relative strength of the manufacturing sector make a Kenyan EPZ program among the potentially most marketable in Africa.

Given the labor-intensive nature of most EPZ industries, Kenya compares favorably with many countries. The Kenyan labor force is young and plentiful, with an estimated 300,000 new workers entering the labor force each year. Wage levels average US$0.27-US$0.40 an hour; unburdened wage levels in the apparel sector, for example, are roughly one-fifteenth and one-twentieth, respectively, of U.S. and West European levels. Kenyan wage levels also compare favorably with leading EPZ countries. In addition, for Asian, U.S., and European investors, Kenya's English-speaking labor force gives its EPZ program a comparative advantage over EPZ programs in Latin America and West Africa.

The quality of basic utilities in Kenya is better than that of many countries which have proven successful in EPZ development, including the Dominican Republic and Mauritius. Likewise, utility costs also compare favorably with other EPZ locations. Internal transportation systems are among the best in Africa. Substantial bottlenecks, however, exist at present in clearance of international ocean and air freight, and port charges are among the highest in the region.

Existing export sector incentives today fall short of the types of benefits that a Kenyan EPZ program could offer. Export-oriented firms in Kenya have welcomed the government's moves to implement "Green Channel" access to foreign exchange and expedited issuance of import licenses (now about two weeks in practice, in contrast to three months or longer previously). Nonetheless, major problems continue to give Kenya a reputation as a far more difficult country to do business in than such locations as Mauritius, Barbados, and other EPZ sponsors. Corporate tax rates in excess of 45 percent apply to businesses operating in Kenya.

Time-consuming paperwork requirements and delays deter industry from making greater use of incentive regimes such as the Export Compensation and Manufacturing-Under-Bond schemes, despite the Green Channel relief measures. Customs clearance procedures are often time-consuming, complex, and expensive for industries dependent upon world market inputs. Access to foreign exchange remains problematic for many export sector firms. Requirements and restrictions on land ownership and land-use by export industries need to be clarified. The Investment Promotion Centre has identified 34 separate authorizations that today may be applicable for firms seeking to do business in Kenya. In such EPZs as Singapore and Hong Kong, by contrast, the investment registration process can be completed in a single afternoon.

High Potential Sectors for Kenyan EPZ Development. In countries sponsoring EPZs 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 activities. Increasingly, labor-intensive information services activities such as data entry, software development, and the like are locating in low-wage EPZs. Market trends in these sectors have supported a rapid growth in exports from EPZs over the past decade to European and North American markets.

Market access to developed countries has been secured by less developed countries through such agreements as the Lomé Convention, HST 9802 of the U.S. Tariff Schedules, and the Generalized System of Preferences; manufactured exports from Kenya are treated favorably under all three agreements. In addition, for companies meeting the criterion of 50-percent Kenyan ownership, access to the regional market of 180 million persons through the Preferential Trade Agreement (PTA) is also assured.

A comparison of the "fit" of Kenya's resource endowments with the needs of the above sectors found that two areas appear to be good candidates for near-term response. Apparel assembly firms seem best suited for rapid commencement of operations. Non-rubber shoe production also seems appropriate for near-term response, and to a lesser degree, fruit and vegetable processing operations may be appropriate given Kenya's natural resource endowment. Electrical/electronic assembly and manufacturing were found to be medium-term rather than near-term operations with potential for Kenyan EPZ, in view of the higher standards of training and support services normally required by firms in this sector.

Demand Analysis. Demand for space within a Kenyan EPZ is likely to be cross-sectoral in terms of light manufacturing activities. While initial demand can be expected from locally based manufacturers, both foreign and domestic, that are familiar with the advantages of a Kenyan location, interest can also be anticipated from East Asian, U.S. and European manufacturers in search of new, low-cost production locations. For locally based firms, the regional market is likely to be the primary destination for a large percentage of their EPZ exports, but significant potential exists for exports to European and U.S. markets for apparel processing operations.

As part of the Kenyan EPZ development strategy to attract both domestic and foreign investment, it is important that a comprehensive package of incentives for export manufacturing be introduced, including, inter alia, expedited Customs procedures, duty-free treatment of EPZ imports and exports, tax relief, a streamlined regulatory mechanism, and unrestricted access to foreign exchange. Introduction of a complete package of these measures is particularly important if a Kenyan EPZ program is to attract foreign investment. The international EPZ market is a highly competitive one, as investors compare EPZ programs worldwide in order to select the program and country which best suits their needs.

Proposed Legal and Regulatory Framework. The design of the EPZ framework for Kenya was based upon a careful consideration of three groups of factors. The regime incorporates the key features of, and is competitive with leading EPZs worldwide; it reflects the requirements of both international companies and the local investor; and it builds upon the comparative advantages of the Kenyan

environment, while offsetting its disadvantages. Unlike the existing Export Compensation and Manufacturing-Under-Bond schemes which are elaborate and difficult to administer, EPZ incentives can be conferred on a "blanket basis" to all qualifying export manufacturing and services firms without the need for elaborate criteria. The EPZ excels in the two critical elements determining the success of export regimes: the comprehensive nature of its package of incentives, and streamlined procedures for granting access to them.

Under the proposed Kenyan EPZ framework, EPZ status is extended to predominantly export-oriented firms and incentives are available on an equal basis to local and foreign investors, and to joint ventures. Developers of EPZ factories and facilities are also eligible for EPZ status. In addition, all exporting firms may apply for EPZ benefits, even those that are located outside of the geographically limited, industrial park-style EPZs. The accessibility of incentives to the widest range of firms and investors possible is an important element of a comprehensive EPZ program, and will ensure that the greatest benefits in terms of expanded exports and employment will be realized.

Key elements of the proposed package of Kenyan EPZ incentives include:

- duty-free treatment of all imports of raw materials, intermediate goods, capital equipment, and construction materials to be used in the export production process or in the development of EPZ factory space;
- exemptions from all licensing and other import and export restrictions;
- 12-year tax holiday on corporate income tax, followed by a flat 10 percent tax thereafter;
- unrestricted repatriation of dividends and invested capital;
- unrestricted access to foreign exchange;
- freedom from price controls and licensing/registration requirements;
- sales to the local market of up to 20 percent of annual production, subject to full payment of applicable duties and levies as a normal important into the domestic customs territory;
- guaranteed access to work permits for key expatriate personnel; and,
- expedited on-site Customs inspection arrangements.

In addition, it is strongly recommended that incentives be provided to the local non-EPZ manufacturer to sell inputs to EPZ industries. Such sales would be considered to be normal exports from the domestic Customs territory, and as such should be made eligible for the Export Compensation and any other partial export scheme that may be introduced. This provision will aid the development of backward linkages between EPZ firms and local firms, thereby spreading further the benefits of the EPZ program throughout the Kenyan economy.

Proposed Institutional Framework. For an EPZ program to succeed, the incentives program as defined "on paper" must be accompanied by an institutional delivery system that will ensure its effective implementation. The experience of successful EPZ sponsoring countries indicates that a range of alternative institutional frameworks are possible, but that the optimal approach consists of designating a single, autonomous businesslike organization -- with strong private sector representation and outlook -- as the single point of

responsibility for zone designations and user approvals. The approach represented by the recently formed Capital Markets Authority in Kenya, which vests unusually comprehensive operating authority in a business-like institution, appears to be the most promising model for creation of a Kenyan EPZ Authority. By creating a new organization, rather than consolidating it within an existing institution, prospects will be enhanced for credible communication to local and foreign investors of the priority given by the Government of Kenya to the EPZ initiative.

The EPZ Authority should have as its purpose the establishment and monitoring of explicit ground rules governing zone developers, users, and service providers. The Authority should not become a zone developer in its own right, but instead should establish impartial criteria regarding zone designations and the authorization of incentives to applicant firms. The application procedures adopted by the Authority should be straight-forward and absolutely "transparent" to the private sector, in order to create confidence among local and foreign businesses alike that zone incentives are accessible to firms on a timely and predictable basis. Likewise, the implementation measures for administration of EPZ benefits, such as expedited Customs procedures, unrestricted access to Foreign exchange, and automatic issuance of expatriate work permits must be carefully defined and effectively executed by the Authority with the support of key Government institutions. In its capacity as overseer of the EPZ regime, the EPZ Authority must have the power to revoke zone incentives and to impose penalties in cases where applicants misrepresent their backgrounds or purposes, or fail to comply with Kenyan laws governing public health, safety, or human rights.

EPZ Ownership and Management Framework. A survey of alternative EPZ ownership and management structures worldwide revealed a number of ownership arrangements which are usable in the Kenyan context. This include private zones, joint public-private ventures, build-operate-transfer arrangements, and long-term leases of government land to private developers. Based on this analysis, it is strongly recommended that the Kenyan EPZ regime support the establishment of zones that maximize the role of the private sector, that investors be allowed to select an EPZ site of their own choosing, and that no matter what form of ownership structure is selected, the EPZ should be operated on a full cost-recovery basis.

EPZ Implementation Plan. The contents and structure of the EPZ regime, as recommended, constitute a major new policy initiative that will build upon the efforts already undertaken by the GOK toward economic liberalization. In order to establish the requisite legislative and institutional framework in support of the program, a concerted effort will be required by both the public and private sectors. The GOK has already formed an inter-ministerial EPZ committee, comprised of key officials that will play a part in the establishment and implementation of the Kenyan EPZ regime. In order for the program to benefit from the broad-based support that will be crucial for its success, the EPZ Committee should be reorganized to include strong private sector representation. The meetings of this "EPZ Working Group" can then serve as an open forum for discussions regarding the drafting on the EPZ legislation, and its implementation, once enacted.

An Implementation Plan has been prepared that identifies seven key objectives for the Ministry of Finance and other public and private institutions over the next 12-month period. If the time frame suggested under the implementation plan is met, both the EPZ enabling legislation and the supporting "implementing regulations" outlining procedural and operational aspects of the regime should be in place before the end of 1990. At the same time, institutional measures should be taken toward the establishment of the EPZ Authority and its assumption of regulatory and administrative responsibility, in coordination with key agencies such as Customs and the Central Bank. Additional effort should be directed toward the creation of new credit mechanisms to finance privately developed EPZ projects and to facilitate the participation of the local business community in export activities through the EPZ program. Likewise, marketing and promotion initiatives must be planned and coordinated among the various national promotional bodies to ensure that both local and foreign investors are aware of the new opportunities that exist for Kenya-based export manufacturing under the EPZ regime.

I. INTRODUCTION AND BACKGROUND

A. REPORT PURPOSE AND ORGANIZATION

1. Purpose

1.01 The purpose of this document is to provide the Government of Kenya (GOK) with recommendations for the design and successful implementation of an Export Processing Zone (EPZ) regime in Kenya. The proposals presented here are intended to assist Kenya in its efforts to catalyze export manufacturing and services activities for broad-based economic growth. Specifically, the study has the following objectives:

- to evaluate the experience of successful EPZ programs and identify the factors responsible for their performance;

- to assess the advantages and constraints of the Kenyan environment in terms of existing legal and regulatory factors affecting export-oriented production activities; and cost and quality of Kenyan factors of production, infrastructure and services from the perspective of EPZ development;

- to identify potential manufacturing and services activities, EPZ user-firms and investors; and,

- based upon the above, to develop a comprehensive legislative and regulatory EPZ package, recommend the optimal institutional and ownership/management framework for implementation of the regime, and outline a comprehensive implementation plan for EPZ development.

In addition, the study reviews alternative EPZ ownership and management strategies, assesses their relative merits within the Kenyan context, and proposes the key elements in the design and implementation of a promotional strategy in support of EPZ development.

1.02 This study has been executed by The Services Group (TSG), in association with Mwaniki Associates (MA) and SRI International (SRI) for the Ministry of Finance (MOF) of the Government of Kenya, under a contract funded by the United States Agency for International Development (USAID).[1] The work effort was initiated the week of October 16, 1989, with two field missions undertaken over the period October 24-November 13, 1989. This document incorporates the preliminary findings presented in a Technical Progress Report submitted to the MOF on November 13, 1989. In the course of the analysis, the TSG project team

---

1 This report has been undertaken by a project team consisting of: Kishore Rao, Project Manager; Cecilia Sager, Principal EPZ Policy Analyst; Alex Quattlebaum, Engineer; and Karen Hendrixson, Policy Analyst (TSG); Ngure Mwaniki, Economist and Tarichia Mugambi, Market Analyst (MA); and Philip Karp, Promotion Specialist and Frank Neider, Market Analyst (SRI).

interviewed 90 representatives of the Kenyan Government, private sector manufacturers, traders, business associations, commercial bankers and others, foreign industrialists and representatives of bilateral and multilateral development institutions. (See Annex A for a full list of interviews).

2. Technical Approach

1.03 The methodology used in carrying out the study was grounded on:

- the experience and current incentives and services offered by competing EPZ locations worldwide;

- the needs and specific requirements of prospective EPZ investors in high potential targeted industry and service sectors and trends affecting end-user markets; and

- the existing attributes of the overall Kenyan environment affecting the potential for export processing enterprises.

1.04 The results of each of these areas of analysis have been integrated in the form of specific recommendations as to the optimal legislative and institutional framework for Kenyan EPZ development and the procedural requirements for the successful implementation of the regime. The recommendations developed for the Kenyan EPZ regime therefore reflect three strategic objectives: they incorporate the successful elements of leading EPZs worldwide, and are competitive with them in terms of incentives and services offered; they meet the needs of end-user markets and of international and local investors in targeted industrial and service sectors; and they complement the existing advantages of the Kenyan environment and offset its competitive disadvantages.

3. Report Organization

1.05 This report is organized according to the following framework.

- The remainder of this chapter presents a background on the free zone concept; identifies various types of zones; and outlines typical EPZ incentives, services and amenities.

- Chapter 2 consists of a comparative analysis of the leading EPZ programs in Asia, Africa/Middle East and the Caribbean Basin region; portrays the growth and proliferation of EPZs internationally; and identifies the "lessons learned" for successful EPZ development.

- Chapter 3 is an assessment of the overall Kenyan environment affecting the potential for EPZ development. The first section evaluates the macro-economic investment climate; analyzes the availability, cost and quality of the basic economic factors of production, economic infrastructure and basic services; and weighs their implications for Kenyan zone development. The second section comprehensively reviews the existing laws, regulatory procedures and

institutional framework that affect export-oriented processing activities in Kenya. The final section summarizes the basic conclusions regarding Kenya's comparative advantages and disadvantages as an EPZ location relative to competitive EPZ locations worldwide.

- Chapter 4 identifies global production and investment trends affecting the potential for Kenyan EPZs in terms of the major end-user markets for EPZ products, and examines the underlying changes of the major direct investment capital-exporting countries in the European Community (EC), the United States, and increasingly the Newly Industrializing Countries (NICs) of the Far East. The chapter briefly identifies priority sectors suited for investment in a Kenyan EPZ, and profiles their requirements for an EPZ regime in terms of incentives, services, facilities and amenities.

- Based upon the above analyses, Chapters 5 outlines the proposed legislative and regulatory framework for the Kenyan EPZ regime. The suggested incentives package reflects the needs to offset internal cost constraints, maintain international competitiveness with other EPZs, and meet the requirements of the local and international investor. (A model framework for Kenyan EPZ legislation is presented in Annex E.)

- Chapter 6 presents alternative models for the implementation of EPZ regimes that have been utilized worldwide, and identifies the advantages and disadvantages of such approaches in the Kenyan setting. A proposed configuration for a Kenyan EPZ regulatory body is also provided.

- Chapter 7 evaluates the link between EPZ project structure and project performance, reviews alternative ownership and management configurations for EPZs, and outlines the key elements of EPZ project design that influence zone performance. Recommendations for such approaches in the Kenyan context are outlined.

- Chapter 8 details an implementation plan for EPZ development in Kenya and identifies key implementation measures.

B. BACKGROUND AND EVOLUTION OF THE FREE ZONE CONCEPT

1. The Free Zone Concept

1.06 The classical free trade zone (FTZ) can be defined as a designated area, physically or administratively located outside the national Customs territory, wherein unrestricted trade is permitted with the rest of the world. Merchandise may be moved into and out of these zones free of Customs duty, stored in warehouses for varying periods, opened for inspection and re-packed for re-export and transshipment.

1.07 Found in all port areas since ancient times, FTZs have been established in almost all trading countries today; examples include the Colon Free Zone in Panama and the free zone in Lomé, Togo.[2] Also known as commercial free zones, these warehousing/transshipment zones usually provide bonded warehouses where goods can be stored duty-free until re-exported or forwarded to a domestic destination (paying the requisite duty). From the perspective of the user, the primary incentive of the commercial free zone is that it permits the rapid delivery of a product in response to an order, meanwhile saving interest costs on Customs duty payments.

1.08 In recent years, increasing numbers of specialized free zones have been established which cater to the needs of specific industries. Zones oriented toward the rapidly growing computer and information services industry, found in the Caribbean Basin, are patterned after modern office parks, offering special telecommunications and other facilities for export-oriented offshore data entry and information services operations. Other types of specialized zones include offshore banking centers in places such as the Cayman Islands and the Bahamas. Similarly, high-technology and science-oriented parks have been successfully created in Taiwan, Israel, Singapore, and elsewhere.

2. The EPZ Concept

1.09 The Export Processing Zone (EPZ), like the classical free zone, is extra-territorial, or outside the national Customs territory. Unlike classical free zones, however, EPZs are explicitly designed to facilitate the processing, manufacture and assembly of goods and services destined (primarily) for export markets. Transactions in EPZs are not subject to import restrictions and tariffs, and therefore escape the delays and administrative costs often associated with other "partial export" regimes.[3] Typically, raw material and intermediate goods are imported and assembled, utilizing the host country's comparative advantage of low-cost labor. A good example is the EPZ program of the Dominican Republic, where apparel and electronic components are imported from the U.S., assembled, and re-exported to the United States.

1.10 The EPZ 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. In practice, most countries offer both options to the investor.

---

[2] For example, Commercial Free Zones have been in existence in Singapore since 1819 and in Hong Kong since 1842. When Hong Kong and Singapore adopted their export-oriented development policies in the 1950s and 1960s, they expanded their Commercial Free Zones into country-wide industrial free zones.

[3] Examples of partial export schemes that benefit producers manufacturing for both the local and export markets simultaneously include duty drawback/exemption, and export compensation schemes, among others.

1.11 The physical infrastructure or "hardware" of the traditional EPZ is a fenced-in industrial park ranging from 30 to 500 acres in size. Industrial park-style EPZs offset 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 EPZs 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 EPZ firms.

1.12 In addition to the industrial park type of EPZ, most countries have special free zones where the EPZ package of incentives is provided on a case-by-case basis to individual factories producing for export. Such "bonded factories" are a practical response to the needs of firms that, for reasons of raw material location (e.g., agricultural, mineral, ocean fishing), cannot be established inside a typical EPZ area. Some countries do not restrict EPZs to a limited area at all. Mauritius, for example, has effectively expanded its EPZ program to include the entire country.

a. Types of Incentives

1.13 There are hundreds of EPZs around the world today. Although they vary in size, design and market orientation they share an essential characteristic. All EPZs provide a simplified business environment -- offering 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 EPZs, a package of duty, tax, and regulatory relief incentives was specifically available to export manufacturers.

1.14 Notwithstanding variations in the types of EPZ incentives provided by host countries, the key characteristic of the EPZ approach is that it seeks to systematically remove barriers to export sector expansion, and as such these incentives are usually embodied in completely separate special legislation. Unlike other regimes offering partial incentives for export manufacturing which are discretionary and difficult to administer, EPZ incentives can be conferred on a blanket basis to qualifying firms without the need for elaborate criteria. EPZ 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.

1.15 The comprehensive nature of the incentives package of the EPZ counter-balances the distortions experienced by manufacturers operating in typical developing country environments that impede their ability to compete in

international markets.[4] By comprehensively offsetting the deterrents to export production, EPZs place developing country manufacturers on an equal footing with their competitors operating in market-oriented economies with relatively free-trade status.

1.16 A typical package of EPZ incentives would include:

- **tariff and trade taxes and duties exemptions.** EPZs 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 EPZs 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 utilized which allows zone firms to have access to foreign exchange at a "free market" rate. EPZs also do not discriminate between local and foreign capital; one of the strongest incentives is 100-percent foreign ownership of EPZ enterprises.

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

1.17 In addition to these basic incentives, many countries offer additional incentives to EPZ firms. The most common of these include:

- sales to the local market upon payment of relevant import duties;

---

[4] 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 structural rigidities in labor markets that set the cost of labor above its opportunity cost.

- differential incentives for locating away from urban centers;
- subsidized factory and office space rental and/or utility rates;
- subsidized employee training programs; and
- changes in labor codes.

1.18 Other than local market access, most of these secondary incentives are often peripheral to the operating concerns of export industries, and it is by no means clear that these additional incentives are an advantageous way to attract EPZ firms. Subsidized factory rates compromise the financial integrity of the zone, thereby draining it of the necessary resources for maintenance and upkeep. In addition, subsidized rates often attract "low-end" producers who are highly sensitive to rental increases and tend not to be stable, long-term tenants. 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 have generated worker unrest in some EPZs and have thus actually inhibited zone performance.

b. Types of Services and Amenities

1.19 In addition to the incentives package, firms often seek specific support services and amenities from an EPZ. The types and degree of support services offered by various zones is extensive, and varies by market, user, and location. Some of the more common services offered include:

- on-site Customs office and full-time officer;
- assistance in complying with government regulations and documentation requirements;
- provision of security services such as guards, fences, lighting, etc.;
- transport facilities for zone workers;
- medical/emergency clinic staffed by a full-time nurse and frequented by a doctor as required; and
- meeting rooms and temporary office space.

In addition, many EPZs provide such services as day-care facilities, banking and postal services, telecommunications links, business facilities and temporary office services, shelter plan operations, and on-site employment centers. Linkages to technical training institutions are increasingly common, as are linkages to service providers such as trucking agencies or computer repair firms.

1.20 As competition among EPZs has risen, zone managers have increasingly begun to offer many of the above services and amenities, either at a specified additional cost or as part of the fixed lease rate. The package of services differentiates the zone from competitors and enhances user-appeal and marketing leverage. As EPZs grow and progress, the provision of a wider range of services has naturally evolved as a way to facilitate market segmentation.

II. COMPARATIVE ANALYSIS OF INTERNATIONAL EPZ PROGRAMS

A. EVOLUTION OF INTERNATIONAL EPZ ACTIVITY

2.01 At present, more than 45 countries worldwide have established EPZ programs. Some 145 industrial park-style EPZs are now operational, accounting for an estimated US$15 billion in annual exports and employing more than 1.5 million workers, excluding the freeports of Hong Kong and Singapore which offer EPZ-style incentives on a country-wide basis. The manufacture of garments, textiles and electronic and electrical goods for export markets accounts for some 80 percent of global EPZ production. Of the 145 operational zones, 36 percent are located in the Asian region, 30 percent in the Caribbean, 14 percent in Central and South America, and 15 percent in the Middle East/Mediterranean region. African countries account for less than five percent of EPZs worldwide.

2.02 The worldwide proliferation of EPZs can be seen in Table 2-1 which shows the cumulative growth in the number of industrial park-style EPZs since 1960. As can be seen, rapid growth in the number of EPZs occurred over the period 1971-75, when some 12 zones were established in Southeast Asian countries, and then

TABLE 2-1
WORLDWIDE GROWTH OF INDUSTRIAL PARK-STYLE EXPORT PROCESSING ZONES
(Cumulative Totals)

	1966	1970	1975	1980	1985	1989
Asia	2	7	19	26	40	52
Middle East	0	0	6	10	17	22
Africa	0	1	3	7	7	7
Caribbean	13	14	17	23	25	43
Central America	0	2	4	7	9	10
South America	0	1	6	8	11	11
Total:	**15**	**25**	**55**	**81**	**109**	**145**

Note: These calculations do not include individual EPZ-designated factories operating outside of geographically limited EPZs such as those found in Mexico, Mauritius, Hong Kong, Singapore and in the Eastern Caribbean nations. Industrial estates providing EPZ-style incentives such as those found in Barbados, Hong Kong and Singapore are included in the calculations. The Mexican industrial estates program offering EPZ-style incentives for export manufacturing enterprises have not been included in the calculations; in 1986, some 70 private and 20 public industrial parks were in existence throughout the country. Data for 1989 are estimates.

Source: Data compiled by TSG.

Positive Page Black

later between 1975-80, when 26 EPZs became operational, mostly in the Caribbean/Central American region. Since 1980, the Caribbean Basin has become the center of worldwide EPZ activity.

2.03 Table 2-2 shows the EPZs in operation in mid-1989. In addition, there are a number of mostly private EPZs that are currently at various stages of development in such diverse locations as Togo, Cameroon, Madagascar, Cape Verde

---

TABLE 2-2
EXPORT PROCESSING ZONES IN OPERATION WORLDWIDE
(mid-1989)

	Number of Zones
Asia	**46**
Bangladesh	1
China	6
Hong Kong	2
India	6
Indonesia	2
Malaysia	10
Pakistan	1
Philippines	6
Singapore	2
South Korea	2
Sri Lanka	2
Taiwan	4
Thailand	2
Middle East	**23**
Cyprus	1
Dubai	1
Egypt	4
Jordan	1
Syria	7
Tunisia	6
Turkey	3
Africa	**7**
Liberia	1
Mauritius	5
Senegal	1

TABLE 2-2 (Continued)
EXPORT PROCESSING ZONES IN OPERATION WORLDWIDE
(mid-1989)

	Number of Zones
Caribbean Basin	**43**
Bahamas	2
Barbados	11
Dominican Republic	16
Haiti	2
Jamaica	4
Puerto Rico	2
Eastern Caribbean	6
Central America	**10**
Costa Rica	4
El Salvador	1
Guatemala	2
Honduras	2
Panama	1
South America	**11**
Brazil	1
Chile	2
Colombia	6
Uruguay	2
TOTAL:	**140**

Source: Data compiled by TSG. Excludes Mexican industrial estates.

and Ethiopia in the African region; Guatemala, El Salvador, Honduras, Belize, Haiti and the Dominican Republic in the Caribbean/Central American region; Fiji and Western Samoa in the Pacific; the Philippines, Thailand, Bangladesh and India in Asia; and Uruguay, Argentina and Brazil in South America. EPZs are also actively being considered for development in various Eastern European countries (Hungary, Poland and Yugoslavia) and in the Soviet Union.

2.04 The development of modern EPZs started with the establishment of a zone at Shannon Airport in Ireland. Established in 1960 to provide a means of stimulating Ireland's industrial growth and revitalizing an airport made largely obsolete, the zone allowed Ireland to capitalize on its relatively low labor costs as an export base to European markets. Within ten years, the Shannon EPZ

employed 8,000 workers and accounted for 20 percent of the country's manufactured exports. The Shannon EPZ is credited with a strong role in reorienting the Irish economy to export-led growth, by leading to the extension of EPZ-style incentives throughout the country.

2.05 Ireland's success was quickly emulated by a number of Asian countries, including Taiwan, South Korea, and Malaysia. By 1970, a total of seven EPZs were established; 30 more EPZs began operations during 1970-75 in the Caribbean Basin and elsewhere. Since the 1960s, the nature and regional pattern of EPZ development have evolved in a number of ways. Many of the earliest established zones have matured, developing significant linkages to the local economy, and much industrial development takes place outside of the zones, or in new specialized zones focusing on specific industries.

2.06 EPZs have also become increasingly specialized and sophisticated in the types of services offered to investors and in the type of products manufactured. Infrastructural facilities are often comparable to those found in developed countries. The regional location of EPZs has also changed, as the Caribbean and Central American countries have witnessed explosive EPZ development in recent years. Finally, the role of the private sector in zone development and management has grown. While EPZ development was once commonly led by government 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.

B. COMPARATIVE ANALYSIS OF LEADING EPZ PROGRAMS

2.07 While the growth of EPZs worldwide has been impressive in the space of three decades, the impact of EPZ development has been unequal. Some EPZs have operated very successfully in locations differing greatly in terms of location, size and economic orientation, however, other EPZs have simply fallen short of their intrinsic economic potential. While there are fundamental elements common to a successful EPZ regime, precise characteristics vary from zone to zone; each individual zone has its own strengths and weaknesses, and there are also considerable differences between zones in their stages of evolution, program characteristics, and policy regimes.

2.08 This section will review the structure, economic contributions, and evolution of EPZs in Asia, Africa, the Middle East, and in the Caribbean Basin. By evaluating the strengths and weaknesses of individuals EPZ programs, and identifying prevailing trends in the design, implementation, and management of selected export processing zones around the world, the discussion will outline key guidelines for successful EPZ development in Kenya.

1. Asian Export Processing Zones

a. Overview

2.09 Some of the most successful EPZ programs in the world, as well as the best established and most numerous, are found in Asia. In Taiwan and South Korea,

for example, export processing zone programs have been in operation for 23 and 18 years, respectively, and have now matured to include some of the most sophisticated, high technology industries in the world. However, other programs started at the same time have failed to yield the same results. In India and the Philippines, the growth and economic impact of EPZs has been less substantial and more recent. As shown in Table 2-3, a comparison of EPZ exports to EPZ jobs shows that each direct employee in Taiwanese and Korean EPZs generated US$26,667 and US$41,667, respectively, in annual exports, compared to US$5,000/employee in Indian and US$6,667 in Filipino EPZs. The reason for such vast variations in economic impact is the differences in the package of incentives offered by various EPZ programs and, more importantly, the administrative measures utilized to implement the regimes.

2.10 Taiwan and India were the first countries in the Asian region to establish export processing zones, beginning in 1966, followed by Korea and Malaysia in 1971, and the Philippines, Indonesia and Singapore in 1972-73. Since 1979, EPZs have been established in Sri Lanka, Bangladesh, China, Pakistan and Thailand. Taiwan is the leading EPZ location in terms of annual exports (in excess of US$2.4 billion), but China and Malaysia account for the largest number of geographically limited EPZs in the region. By far, among zones for which

TABLE 2-3
PROFILE OF ASIAN EPZ PROGRAMS
(1989 Estimates)

	Date Started	No.of Zones	Direct Employment	Annual Exports
Bangladesh	1980	1	n/a	n/a
China	1982	6	200,000	n/a
Hong Kong	1977	2	n/a	n/a
India	1965	6	20,000	US$ 100m
Indonesia	1973	2	15,000	US$ 25m
Malaysia	1971	10	100,000	US$1600m
Pakistan	1983	1	1,000	n/a
Philippines	1972	6	30,000	US$ 200m
Singapore	1972	2	90,000	US$1600m
South Korea	1971	2	36,000	US$1500m
Sri Lanka	1979	2	30,000	US$ 85m
Taiwan	1966	4	90,000	US$2400m
Thailand	1981	2	20,000	n/a
TOTAL:		**46**	**632,000**	--

Source: Data compiled by TSG.

statistics are available, the most successful Asian zones are those in Taiwan and South Korea, and the rest of the discussion will focus on these two countries.

b. Historic and Current Economic Contributions

2.11 **Taiwan.** Between 1966-71, Taiwan established three geographically defined EPZs at various locations, covering an area of less than four square kilometers. Within five years after the Government of Taiwan spent US$12 million in setting up the EPZs, the zones attracted thirteen times as much in direct foreign investment and generated eight times as much in annual foreign exchange earnings from export sales. By 1979, the net foreign exchange earnings of the three EPZs accounted for almost 70 percent of the country's balance of trade surplus and 56 percent of total investment in export manufacturing. EPZ exports account for over five percent of total country exports today.

2.12 As shown in Table 2-4, zone industries have cumulatively generated more than 50 percent of Taiwan's net foreign exchange earnings since 1970, totalling at least US$20 billion over the period 1970-88. Of the total earnings of the three EPZs in Taiwan between 1966-86, approximately 75 percent was used to pay for local costs, leaving a substantial amount of foreign exchange in the country. The high net foreign exchange earnings of the Taiwanese EPZs are due to the progressively higher utilization of Taiwanese-sourced raw materials and intermediate goods by EPZ companies. In 1967, only two percent of EPZ inputs were of local origin; by 1980, over one third of EPZ imports were of local origin. Today, over 1,000 Taiwanese firms outside of the zones produce products for EPZ firms, providing more than US$362 million in inputs in 1987 alone.

TABLE 2-4
GROWTH IN EPZ EXPORT EARNINGS IN TAIWAN AND KOREA
(US$ millions)

	TOTAL EPZ EXPORTS		NET FOREIGN EXCHANGE EARNINGS	
	Taiwan	Korea	Taiwan	Korea
1967:	80	--	8	--
1970:	110	0.9	19	0.2
1976:	800	200	250	75
1980:	1,463	674	600	290
1984:	1,700	800	900	330
1988:	2,400	1,500	1,600	720

Source: Data compiled by TSG.

2.13 The rapid growth of the Taiwanese EPZs can be traced to large inflows of direct foreign investment which reached a peak in 1973 with total capital investment of US$282 million; of this, over 65 percent was foreign and 12 percent was local. During the first 13 years of operation ending in 1979, an average of 12 factories per year closed down, representing 11 percent of total investment captured during the period. Today, over 300 factories with aggregate US$400 million in total capital outlay operate in the zones.

2.14 As shown in Table 2-5, employment creation in the Taiwanese EPZs has been sustained even through the worldwide economic recession in the early 1980s. Between 1967-80, over 72,000 jobs were generated in the three EPZs; between 1980-88, an additional 20,000 were generated. By the standards of other EPZ locations such as Mauritius or the Dominican Republic, the direct employment impact of the Taiwanese EPZs has been limited. This is due primarily to the fact that the Taiwanese Government decided not to expand the zones, which are close to fully occupied, but rather to extend EPZ-style policies to the country as a whole. The nature of industrial activity has also changed. In 1976, only 20 percent of EPZ jobs were technical or managerial; by 1986, this share had reached 60 percent. The trend toward high-technology, capital-intensive jobs can be seen in Table 2-5 which shows that average annual exports per job in the Taiwanese EPZs increased from US$1,025 in 1967 to over US$26,000 in 1988.

2.15 **South Korea.** Initiated in 1971, the Korean EPZ program encompasses two EPZs owned and operated by the government. Japanese firms account for 70 percent of EPZ firms and Japan is the largest market for EPZ exports. Between 1973-86, Korean EPZ manufactured exports grew by more than 30 percent per annum in real terms, reaching more than US$1.5 billion in 1988. Net foreign exchange earnings

TABLE 2-5
EMPLOYMENT CREATION AND EXPORT SALES/JOB IN TAIWANESE AND KOREAN EPZS

	EMPLOYMENT		US$ EXPORTS/JOB	
	Taiwan	Korea	Taiwan	Korea
1967:	8,000	--	1,025	--
1970:	38,000	1,200	2,895	750
1976:	72,000	22,000	6,375	9,090
1980:	80,000	30,000	18,288	22,467
1984:	87,000	34,000	19,540	23,530
1988:	90,000	36,000	26,667	41,667

Source: Data compiled from TSG field missions.

averaged a very high 65 percent of total EPZ exports, stimulated by government measures to extend EPZ-style incentives to local industry. As a result of this policy initiative, the Korean EPZs became gradually less important as

manufactured exports from the non-EPZ sector accelerated. Today, Korean EPZ exports account for less than three percent of total country exports. In 1987, the two Korean EPZs employed 36,000 workers, and the six industrial estates with EPZ-style incentives employed in excess of 100,000.

2.16 In 1987, EPZ exports accounted for only three percent of total exports. As in Taiwan, EPZ firms have established over time significant links to the local economy. In the Masan EPZ, which is home to 76 of Korea's EPZ firms, about 44 percent of all production materials are sourced from domestic suppliers, up from only six percent in 1971.

2.17 The pattern of employment creation in the Korean EPZs has mirrored that of Taiwan, with a pronounced trend from highly labor-intensive to capital-intensive operations. Direct employment in the two EPZs increased eighteen times between 1970-76; subsequent increases have been limited due to the fact that the EPZs are full and the government is discouraging further investment in them.

2.18 A major contribution of the EPZ program and export-oriented policies has been a rising standard of living. As a result, South Korean and Taiwanese wage levels have become less competitive internationally, and a large number of labor-intensive firms have moved to other nations. In addition, the success of EPZ programs has led to the zones' decreasing relative importance. In Taiwan, the three general purpose zones are all but fully occupied, leaving little room for EPZ firms to expand. More importantly, the extension of many EPZ-type incentives throughout the country has reduced the zones' relative attractiveness.[1]

c. Evolution of the EPZ Policy Regimes

2.19 As some of the earliest EPZ locations, Taiwan and South Korea have gradually modified their EPZ policy regimes over time. In both countries the EPZs were initiated as part of an overall effort to re-orient economic activity from import-substituting production to export manufacturing. The EPZ regime was viewed in both countries as the most liberal of the export promotion schemes, oriented primarily (and in the case of Korea, exclusively) to the promotion of direct foreign investment in 100-percent export manufacturing.

2.20 Two general observations can be made about the evolution of the EPZ policy framework in Taiwan. First, it is clear that the EPZ regime provided a "testing ground" for policies that were subsequently extended to manufacturers operating outside the zones. This is true especially in the area of import liberalization where average tariff levels were reduced by more than 50 percent over the period 1963-67, and in terms of foreign exchange controls, which were liberalized

---

[1] The growth of export manufacturing activities outside of the Taiwanese and Korean EPZs has been significant. In addition to the three Taiwanese EPZs, for example, there are some 60 industrial estates whose occupants enjoy EPZ-style incentives and have no limit on sales to the local market. In Korea, more than 30 industrial estates provide tenants with EPZ-style incentives, and are free from local ownership and other restrictions.

significantly from 1970-75. Second, Taiwan has made a strong effort to encourage the upgrading of EPZ activities into higher technology areas by both discouraging further investments in highly labor-intensive activities such as garments assembly, and requiring a (high) minimum deposit of US$158,000 for new EPZ firms. It should be noted that such measures were taken a full decade after the first EPZ began operations and the zone was completely leased (committed) in 12 months. In addition, the Hsin-Chu Science-Based Industrial Park was established in 1980 to encourage high-technology exports.

2.21 In the case of Korea, the focus of the EPZ program from inception was to exclusively promote direct foreign investment: the EPZ incentives package strongly supported foreign rather than local investment. Local investors were restricted to a minority shareholding in EPZ enterprises, limited to a 50 percent, rather than full, reduction in corporate income tax obliged to fully pay personal income taxes, and restricted in their ability to send capital and profits overseas. As shown in Table 2-6, however, restrictions on local ownership were largely eliminated in 1980 as a part of concerted move to ensure more local participation in wholly export-oriented activities. In recent years, the government has discouraged further investment in the EPZs (which are fully occupied) and has shown no willingness to develop additional zones, preferring instead to decentralize economic activity.

d. Comparison of the Incentives Packages

2.22 As seen in Table 2-7, although the types of programs and incentive packages offered in both countries are highly similar, there are differences in degree. By and large, Korean EPZs are more generous than the Taiwanese. Imports and exports are duty-free and there are no restrictions on the repatriation of either profits or capital. There are no restrictions on foreign or local ownership in either country. EPZ firms in South Korea receive an exemption from corporate income taxes for five years; in Taiwan, firms can choose either the same tax holiday or opt for a 20 percent flat tax rate.

2.23 Firms in Taiwan pay a 20 percent rate of tax on dividends, while South Korean firms are completely exempt from such taxes for five years. Investments are approved rapidly in both countries: within 10 to 30 days in Taiwan, and 30 to 60 days in South Korea. In addition, both countries sharply restrict sales by EPZ firms to the local market. Finally, both offer additional incentives to attract high technology firms. The most significant difference between the two countries is in the foreign currency regime. In Taiwan, as with most successful EPZs, management of foreign exchange is unrestricted, although strict controls existed up to 1987. In South Korea, the management of foreign currency is still controlled by the Central Bank. Comparative incentives for other selected Asian EPZs programs are presented in Table 2-8.

TABLE 2-6
EVOLUTION OF THE EPZ POLICY REGIMES IN TAIWAN AND KOREA

Year	Measure
1965	Statute for Establishment and Management of EPZs enacted in Taiwan, outlining basic package of incentives for the EPZs.
1966	Kaoshiung EPZ established to attract foreign investment in export-oriented manufacturing activities in Taiwan.
1969	Government-owned Nantze and Taichung EPZs established in Taiwan.
1970	Free Export Zone Establishment Act is enacted in Korea to encourage foreign direct investment. Local investment in EPZ enterprises restricted to joint ventures with foreigners. Foreigners are not allowed to own EPZ land.
1974	All new EPZ firms required to make minimum capital investment of US$158,000, and are discouraged from investing in highly labor-intensive activities such as garments (Taiwan).
1980	Hsin-Chu Science-based Industrial Park opened to encourage development of high-technology exports. (Taiwan)
1980	Korean Government amends the Free Export Zone Establishment Act, allowing for 100-percent local ownership of EPZ firms.

Source: Information Compiled by TSG.

e. Zone Management and Regulation

2.24 In both countries, the government has been actively involved in the establishment, regulation and management of the EPZ program. All of Taiwan's EPZs are owned and managed by the public sector Export Processing Zone Administration, a division of the Ministry of Economic Affairs. South Korea's two EPZs are likewise owned by the government.[2] In addition, both governments have been extensively involved with export promotion efforts, have met frequently

[2] Most of Taiwan's industrial parks, however, which offer many of the same incentives as do the EPZs, are privately managed, although some are managed by agencies associated with the government. Similarly, private industrial estates operate in South Korea.

TABLE 2-7
COMPARISON OF EPZ INCENTIVES IN TAIWAN AND KOREA

	Taiwan	South Korea
Tax Abatement:	- corporate income tax: 100% for 5 years; or 20% flat tax rate - exemption from other indirect taxes	- corp. income tax: 100% for 5 years; 50% for next 3 years - exemption from property, acquisition and other indirect taxes - exemption from aliens' personal income tax
Duty Treatment:	- 100% exemption on imports of raw materials, parts, machinery, and on all exports	- 100% exemption on imports of capital goods, raw materials, parts and semi-finished goods, and on all zone exports
Capital/Profits Repatriation:	- No restrictions	- No restrictions
Dividends:	- 20% tax	- 5-year tax holiday; 50% reduction for 3 yrs
Restrictions on Foreign/Local Ownership:	- No restrictions	- No restrictions
Sales to Local Market:	- Strictly controlled; 2% of annual output	- N/A
Management of Foreign Currency:	- Unrestricted	- Controlled, access to foreign exchange requires authorization
Eligibility Requirements:	- minimum 25% value-added requirement; minimum US$500,000 investment	- N/A

N/A = not available

TABLE 2-8
COMPARISON OF EXPORT INCENTIVES IN ASIAN COUNTRIES

	Bangladesh (EPZ)	Hong Kong (Export Sector)	India (EPZ)	Indonesia (EPZ)	Malaysia (EPZ)
Corporate Income Tax Abatement	100% exemption for 5 years; 50% exemption after 5 years for export sales	18% tax on corporate income	100% exemption for 5 years during first 8 years of operation	Variable reductions on 20-45% tax rates; accelerated depreciation	95% exemption for 5 years
Capital/Profits Repatriation	Unrestricted	Unrestricted	Guaranteed after tax payments	Repatriation of capital subject to approval	Unrestricted
Duty Treatment for All Imports and Exports	100% exemption	100% exemption	100% exemption	100% exemption	100% exemption for new goods deemed essential and directly used for manufacturing
No. of Days To Receive Approval	Not available	1	45	30-180	Not available
Tax on Dividends	Not available	None	25% tax	20% tax	10% tax
Restrictions on Foreign or Local Ownership	Subject to controls	None	None	Subject to controls	None
Sales To Local Market	Not available	Unrestricted	20% of total output	Not allowed	20% of total output
Management of Foreign Currency	Access only to foreign exchange accounts in foreign and domestic private banks located in the EPZ	Unrestricted	Controlled	Controlled	Controlled

Source: Data compiled by TSG.

TABLE 2-8 (Continued)
COMPARISON OF EXPORT INCENTIVES IN ASIAN COUNTRIES

	Pakistan (EPZ)	Philippines (EPZ)	Singapore (Science Park)	Sri Lanka (EPZ)	Thailand (EPZ)
Corporate Income Tax Abatement	100% exemption until year 2000	35% tax on corporate income	33% tax on corporate income	100% exemption for up to 100 years	100% exemption for 3-8 year, reductions thereafter for 5 years; loss carryforward for 5 years
Capital/Profits Repatriation	Unrestricted for foreign investment only	Subject to the availability of foreign currency	Unrestricted	Unrestricted	Unrestricted
Duty Treatment for All Imports and Exports	100% exemption	100% exemption	100% exemption for most items	100% exemption	100% exemption
No. of Days To Receive Approval	Not available	10-30	30	30-60	90
Tax on Dividends	100% exemption	35% tax	100% exemption	100% exemption	100% exemption for 5 years
Restrictions on Foreign or Local Ownership	Local investment limited to 40% total investment	No foreign ownership of land permitted	None	None	Subject to controls
Sales To Local Market	Unrestricted	2% of total output	Unrestricted	5-10% of total output; decided on a case-by-case basis	20% of total output
Management of Foreign Currency	Unrestricted	Priority in allocation of foreign exchange	Unrestricted	Unrestricted	Controlled during foreign exchange crises

Source: Data compiled by TSG.

with business leaders, and have actively encouraged exporters to expand export levels. In general, the success of both countries' EPZs has been the result of the fact that the EPZ programs have been run on a cost-recovery, businesslike basis, with strong involvement of the private sector in all aspects of decisionmaking.

2.25 The success of the EPZs can also be linked to the efficiency of the zone management/regulatory bodies. In both Taiwan and Korea, the government directly owns and operates the EPZs and also acts as a regulatory body ensuring full compliance with the EPZ laws. Both Taiwan and South Korea provide a "one-stop-shop" service where investors can complete the entire zone investment application procedure under one roof; the efficiency of this form of application process is reflected in the rapid turnaround time for investment approval. In Taiwan, the EPZ investment approval function is exercised by the Joint Industrial Investment Service Center, which has private sector representation. In Korea, the entire responsibility of regulating the EPZ regime was decentralized to each zone's on-site Administrator who represents all relevant Ministries, coordinates Customs activities within the zone, and independently approves all applications and licenses. A special branch of the Bank of Taiwan is also located on-site to independently facilitate all foreign exchange transactions.

2. African/Middle Eastern Export Processing Zones

a. Overview

2.26 Sub-Saharan Africa accounts for less than five percent of global EPZ activity. To date, Mauritius is the only successful operating EPZ location in the African region. Although a number of export processing zones have been established on the African continent, none has functioned successfully or competitively. As shown by Table 2-9, EPZs are found in three countries in sub-Saharan Africa; commercial free zones are found in many other countries in the area. The dismal performance of the EPZ in Liberia (which is essentially defunct) and in Senegal stands in sharp contrast to Mauritius which has effectively declared the entire island an EPZ site. As a result of sound government economic policies and export-oriented trade structure, combined with favorable external market conditions, Mauritius has evolved from a mono-crop agricultural economy into a diversified manufacturing export-oriented economy within two decades.

2.27 In the Middle Eastern region, EPZ development accelerated in the mid-1970s in Jordan, Egypt, Tunisia and Syria, where general industrial estates and established commercial free zones were reconfigured and re-classified as industrial free zones. In general, the overall performance of these zones has been marginal, except in the cases of Egypt, Turkey, and Dubai. In particular, the Jebel Ali Free Zone in Dubai has managed to attract large investments from some 200 companies investing over US$500 million in various activities.

TABLE 2-9
PROFILE OF OPERATING AFRICAN/MIDDLE EASTERN EPZ PROGRAMS

	Date Started	No.of Zones	Direct Employment	Annual Exports
Cyprus	1982	1	n/a	n/a
Dubai	1979	1	6,000	n/a
Egypt	1974	4	20,000	n/a
Jordan	1973	1	n/a	n/a
Liberia	1975	1	15	n/a
Mauritius	1970	6	100,000	US$500m
Senegal	1974	1	600	US$ 15m
Syria	1978	7	2,000	n/a
Togo	1989	--	--	--
Tunisia	1972	6	n/a	n/a
Turkey	1986	3	n/a	n/a

Note: Data for Mauritius includes non-industrial estate EPZ activity.

Source: Data compiled by TSG.

b. Historic and Current Economic Contributions

2.28 **Mauritius**. Since creation of the Export Processing Zone program in 1970, Mauritius -- a country of approximately one million in population -- has become a major center of export manufacturing activity. Between 1982-88, EPZ manufactured exports (predominantly to U.S. and European markets) have grown by 30 percent per year, exceeding US$520 million in 1988. The EPZ sector has generated almost 100,000 jobs in a total of six industrial estates and some 530 individual factories granted EPZ status.

2.29 In 1985, the value of EPZ exports surpassed those of sugar, long the main source of export earnings for the economy. The explosive growth of the EPZ program is the main factor accounting for the turnaround of the US$79 million trade deficit in 1985 into a US$55 million trade surplus in 1986. In 1988 alone, 150 new companies established EPZ operations on the island, creating some 18,000 jobs. Through its EPZs, Mauritius has been able to reduce its unemployment rate of 23 percent in 1982 to less than three percent today. Apparel and textile firms produce 73 percent of EPZ output, which is primarily oriented towards European markets.

2.30 As shown in Table 2-10, the Mauritian EPZ program has undergone three phases between 1970 and 1988. After introduction of the first phase in 1970, the value of manufactured exports increased thirty-fold in the 1972-79 period,

and employment increased at the rate of 4.2 percent per annum. Nine companies began operations in the first year, and by 1977, 89 were in operation. In the second phase, beginning in the late 1970s, EPZ performance began to slacken. The number of new firms slowed, and in 1978, closures actually exceeded new entrants. Recession in the industrial nations, the market for EPZ exports, combined with rising oil prices and falling sugar prices led to economic stagnation. In addition, expansionary fiscal policies meant that wages grew faster than productivity, making some EPZ companies uncompetitive.

2.31 Beginning in 1979, the government began to introduce a series of structural adjustment and export-oriented reforms in order to reverse this economic decline. As a result of these reforms, the Mauritian economy has again entered a boom phase. EPZ exports grew at an annual rate of 28 percent between 1982-87, and real GDP growth rate has averaged 5.6 percent per year in the same period. Inflation fell from 11.4 percent in 1982, to 0.6 percent in 1987. The number of companies operating in the zones quadrupled, with 95 firms entering in 1985 alone. Net foreign exchange earnings from EPZ companies in 1987 totalled approximately $132 million.

TABLE 2-10
ECONOMIC IMPACT OF MAURITIAN EPZS

	Exports (US$ millions)	Employment	No. of Firms
1971:	17.8	600	10
1975:	72.9	2,100	64
1980:	116.4	10,000	101
1984:	155.9	38,000	195
1988:	482.0	100,000	530

Source: Data compiled by TSG

2.32 One of the most important economic benefits of the EPZ program has been the resultant diversification of the Mauritian economy. In the mid-1960s, exports from Mauritius consisted solely of agricultural goods, primarily sugar. In 1982, sugar still accounted for nearly 62 percent of all exports. By 1987, sugar's share of total export value had fallen to 38 percent, while EPZ exports rose from 31 to 59 percent in the same period. This increase in the export of manufactured goods has played a critical role in reducing the nation's vulnerability to the price fluctuations associated with primary commodity exports.

2.33 The EPZ program is notable for the extent to which it has attracted local investment and in the degree to which EPZ sites are not confined to geographically distinct areas. Today, 55 percent of all EPZ investment is

Mauritian-owned, without any form of government decree requiring local ownership. In addition, the geographic dispersion of EPZ factories has spread the employment and technical gains associated with EPZ development throughout the population, avoiding the problems such as congestion which can accompany concentrated development. This policy has been deliberate, and has been facilitated by the island's small size and by a relatively good road network which facilitates the transport of raw materials and finished goods around the country.

2.34 Access to European markets under the provisions of the Lomé Convention has been a critical factor in the growth of Mauritian exports. In 1987, 70 percent of the country's exports went to the members of the European Community. In addition, a number of factors unique to Mauritius have contributed to the phenomenal success of its EPZ program. Investments and exports have probably been favorably affected by the country's former colonial relationship with both France and Britain, and by cultural links with Hong Kong and India. In addition, the workforce is widely educated (the literacy rate approaches 90 percent), commonly bilingual, and a large entrepreneurial class exists. These factors stimulated investor interest, and together explain why Mauritius has been more successful than other African countries in exploiting access to the European market under the Lomé Accords.

2.35 Currently, EPZ growth is beginning to slow, possibly indicating that the economy is reaching the limits of textile and garment exports and that further diversification is needed. EPZ growth rates have slowed to 14 percent in 1988, compared to 35 percent and 22 percent respectively in 1986 and 1987. In the first quarter of 1989, the total number of EPZ firms fell with the closure of 46 firms, and total EPZ employment fell by 2.5 percent between June 1988 and March 1989, forcing manufacturers to adopt more capital-intensive methods and to produce higher value-added export products. For example, the government is currently trying to encourage the production of "up-market" textiles, with higher value-added, and two of the largest companies have introduced computer-controlled knitting machines.

2.36 In 1989, to offset Mauritius' current "overemployment" and to encourage capital-intensive production, the government has established a special lending fund to aid textile firms (which account for some three-quarters of all EPZ exports) to modernize their equipment. In addition, because more capital-intensive production methods require a more skilled workforce, the government has introduced fiscal incentives to encourage firms to expand training programs, and foreign exchange controls have been still further liberalized. The role of the Mauritian Export Development and Investment Agency has been shifted from investment to export promotion activities, and plans are underway for an export financing program for small-scale entrepreneurs.

2.37 **Senegal**. By contrast, although the Dakar EPZ was established in 1974, only a few years after the first EPZs began operation in Mauritius, the economic contribution of the Dakar zone has been minimal. To date, the zone contains approximately 10 firms, and employs less than 600 workers. While this total represents an increase over the 450 workers employed in the zone in 1984, it is far below the level originally anticipated. In 1987, total EPZ exports were almost US$15 million, primarily to regional markets in West Africa. Despite a relatively favorable incentive package, duty-free access to the European

Community under the Lomé Convention, and far closer geographical proximity to European markets, Senegal's EPZ program has performed poorly relative to that of Mauritius.

2.38 **Turkey**. The Turkish EPZ program is one of the most liberal in the region and is oriented to attracting foreign investment predominantly from the United States and Europe. In addition to existing zones at Mersin and Antalya, the Turkish government signed an accord with the U.S.-based Bechtel Corporation to establish a third EPZ in Adana-Yumurtalik, utilizing a "build-operate-transfer" mechanism; this specific accord has been dissolved, but a Japanese concern is now undertaking a similar venture. Under this approach, a consortium will build a fully developed site owned by the government, operate the zone for 15 or 20 years, and then transfer ownership of the facility to local authorities. The impact of the EPZs has been quite positive, but data are scarce. Reportedly, some 100 companies are already in operation, including 30 foreign enterprises, out of over 500 applications already submitted.

c. Evolution of the EPZ Policy Regimes

2.39 **Mauritius**. As with South Korea and Taiwan, the Mauritian EPZ program was introduced after many years of import substitution policies. In 1970, when it was clear that these policies had run their course in stimulating growth in Mauritius' small domestic market, the government adopted an export-oriented strategy. From inception, a conscious decision was made by the government not to limit EPZs to a geographically defined area. The country was effectively designated an export processing zone and a generous incentive package was introduced in 1970 through the passage of the Export Processing Zones Act.

2.40 As shown in Table 2-11, the evolution of the EPZ policy regime in Mauritius has been the result of deliberate moves made by the government in consultation with the private sector. The success of the Mauritian EPZ program can be attributed both to the attractiveness of the regime, and to macro-economic policies pursued by the government that ensured the regime's competitiveness over time. After the initial success of the EPZ, the economic difficulties experienced in 1979 brought recognition that the EPZ regime had lost its competitiveness. In reaction, the government introduced, beginning in 1979, a series of liberalizing reforms of the exchange rate, and quota and tariff schedules. Most important of these was the devaluation of the Mauritian rupee by 50 percent between 1979-81. In addition, the currency was linked in 1983 to a basket of currencies representing Mauritius' major trading partners.

2.41 The impact of the initial 10-year corporate income tax holiday was beginning to have unintended results by the early 1980s. EPZ firms shut down and formed new companies in order to remain competitive. The tax holiday also favored activities yielding quick profits, while discriminating against longer-term activities. In response in 1980, the corporate income tax holiday was

TABLE 2-11
EVOLUTION OF THE EPZ POLICY REGIME IN MAURITIUS

Year	Measure
1970	Export Processing Zones Act passed to encourage wholly export-oriented manufacturing activities.
1979	Mauritian rupee devalued by 30 percent.
1980	Export Services Zone Act enacted to encourage the development of export-oriented service organizations.
	EPZ Act was modified to extend the tax holiday available beyond the 10th year on a declining basis: 50 percent exemption for years 11-15 and 25 percent exemption from years 16-20. Dividends tax free for any five-year period during this period.
1981	Mauritian rupee devalued by 20 percent.
	Introduction of the Export Credit Guarantee Scheme and the Export Credit Insurance Scheme.
1983	Mauritian rupee delinked from the SDR and linked to a basket of currencies more representative of the country's trading partners.
1984	The Industrial Coordination Unit was established as a one-stop-shop to streamline EPZ investment applications procedures
	The Mauritius Export Development and Investment Authority established to promote investment and develop and operate industrial estates.
	Minimum wage for male EPZ workers abolished, but was continued for women as a measure to increase male employment.
1985	Different tax rates for EPZ, ESZ (Export Services Zone) and other export enterprises unified into a flat corporate income tax of 15 percent over the life of the company. Dividends exempted from income tax for 10 years.
1986	Female employment in EPZ enterprises prohibited after 10:00 pm to encourage male employment.

Source: Information compiled by TSG from various sources.

extended beyond 10 years on a declining basis. However, the fiscal reforms were not powerful enough to strengthen the regime, and in 1985 a flat 15-percent corporate income tax was offered to all export enterprises.[3]

2.42 Institutional changes accompanied these policy changes in the early 1980s. A one-stop-shop was established in order to streamline and accelerate investment approvals. The Mauritius Export Development and Investment Authority (MEDIA) was established in order to carry out investment and export promotion. The government also intervened in trying to offset the imbalance between the sexes in terms of EPZ employment. By 1984, some 80 percent of EPZ employees were female. To redress this situation and encourage male employment the government in 1984-86 abolished a minimum wage for male employees and banned night work by female workers. As a result of these initiatives -- which were undertaken only after the EPZs were successful -- the level of male employment increased significantly.

2.43 Overall, the Mauritian EPZ policy framework has been characterized by the following:

- an attractive and comprehensive framework of incentives was created to enhance market forces and not replace them;
- modifications to the basic policy scheme were undertaken gradually, and not suddenly at the first sign of trouble;
- there has been a strong trend towards greater liberalization of policy and strong direct private sector involvement in policy making;
- the implementation of the policy framework has been characterized by a streamlined bureaucratic structure; and
- the EPZ framework has been strongly supported by certain macro-economic policies designed to ensure the scheme's competitiveness, including the maintenance of realistic exchange rates; conservative labor policies that kept have wages in line with the opportunity cost of labor; and conservative monetary and fiscal policies.

2.44 Today, the overwhelming success of the Mauritian EPZ program is forcing further changes in the nature of the program and market strategy. The estimated rate of unemployment for 1989 is 2.8 percent. This labor shortage is placing upward pressure on wage rates, and in combination with rising import prices, have raised inflation rates still further, to an estimated 16 percent in 1989, up from 9.2 percent the previous year, and well above the 4.1 percent averaged for the 1984-87 period. As a result, the government is strengthening the EPZ and ESZ regimes to encourage diversification into informatics and other higher-technology areas and is facilitating the upgrading of existing industry.

2.45 **Senegal**. The Senegalese EPZ has operated under a variety of bureaucratic and policy constraints. For the first 11 years of the zone's operation, EPZ legislation required that all investments have a minimum value of 100 million CFA francs (approximately US$350,000) over two years, and create at least 100

---

[3] Existing EPZ enterprises were given the choice of remaining with the existing tax regime.

jobs. In 1985, the government revised the legislation to make these numbers negotiable.

2.46 Unlike the Mauritian EPZ program, the Dakar EPZ has not been characterized by comprehensive liberalization in economic policies. Possible economic diversification is hindered by the fact that the national currency of Senegal (the CFA franc) is linked to the French franc, thereby limiting the possibility of employing exchange rate valuation as an effective policy instrument. As a result, the high level of the CFA franc has made Senegalese exports uncompetitive in much of the world. In addition, zone exports have been primarily destined for West African markets; a number of the first zone firms failed due to import restrictions, economic instability and poor infrastructure in the region.

2.47 Infrastructure deficiencies have also inhibited the zone's attractiveness. Wage rates in Senegal are high relative to the rest of the region, labor productivity is low, and despite a liberalization of labor laws in 1986, firms still require government approval to lay off workers. For much of the zone's history, power distribution in the Dakar region has been characterized by low efficiency, serving as a further deterrent to potential zone entrants. EPZ performance in Senegal has also been negatively affected by the absence of standard factory shells. Pre-built factories are powerful incentives to investors because they enable production to begin quickly, thereby reducing initial capital expenditure. Finally, despite Senegal's excellent port and closer proximity to European markets, this geographical advantage over EPZs such as those in Mauritius or in the Far East is negated by prohibitively high cargo rates between Senegal and Europe.

d. Comparison of the Incentives Packages

2.48 As shown by Table 2-12, under the Mauritian EPZ program, incentives are available to qualifying firms operating in industrial sites anywhere on the island. The package of incentives offered by Mauritius compares favorably to those found in the major Asian EPZs. All imports and exports are completely duty-free, and there are no restrictions on the repatriation of capital or profits, on foreign ownership, or on the management of foreign exchange. Dividends are exempt from tax for 10 years. As seen above, unlike most EPZs, no exemptions are granted on corporate income tax, but rather a flat rate of 15 percent is charged for the life of the company. Sales to the local market are prohibited, but the turnaround time of 20 to 40 days for investment approval compares favorably to other export processing zones around the world.

2.49 On paper at least, the Dakar EPZ in Senegal offers highly attractive incentives. All equipment, raw materials, finished and semi-finished products are exempt from all taxes and custom duties; similarly, end products are exempt from excise duties and taxes. In addition, firms are exempt until 1999 of all taxes on profits, registration production, patents, and property. Sales to the local market are permissible in cases where such sales do not compete with local industry. Finally, since the Senegalese currency, the CFA franc, is linked to the French franc, it is fully convertible and profits are easily expatriated.

TABLE 2-12
COMPARISON OF EXPORT INCENTIVES IN AFRICAN AND MIDDLE EASTERN COUNTRIES

	Dubai (EPZ)	Egypt (EPZ)	Mauritius (EPZ)	Senegal (EPZ)	Turkey (EPZ)
Corporate Income Tax Abatement	100% exemption for 15 years; renewable	100% exemption for 5-15 years	15% tax rate	100% exemption until year 1999	100% exemption in perpetuity
Capital/Profits Repatriation	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted
Duty Treatment for All Imports and Exports	100% exemption	100% exemption	100% exemption	100% exemption	100% exemption
No. of Days To Receive Approval	Not available	Not available	20-40	Not available	Subject to availability of space in EPZs
Tax on Dividends	100% exemption	100% exemption up to 5% of dividend value	100% exemption for 10 years	100% exemption	100% exemption
Restrictions on Foreign or Local Ownership	None	Subject to control	None	None	Subject to control
Sales To Local Market	Unrestricted	Unrestricted	10% of total output	20-25% of total output unless disruptive to local industry	Not available
Management of Foreign Currency	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted

Source: Data compiled by TSG.

2.50 It is also possible for non-zone firms in Senegal to receive benefits similar to those offered to EPZ companies. Firms which make a minimum investment of 200 million CFA francs (US $700,000) or which create at least 50 permanent jobs for Senegalese workers can acquire a "priority undertaking" classification. Companies with this classification are eligible for duty-free importation of machinery for three years, and spare parts for five years; reductions of duty on importation of raw materials, and exemptions from various land revenue taxes. Projects which are located outside of the Dakar region are eligible for further concessions. Firms that do not qualify for these incentives, and which do not locate in the EPZ, are subject to substantial rates of taxation.

e. Zone Management and Regulation

2.51 The ownership and management structure of EPZs in the Africa/Middle East region are extremely diverse, reflecting the nuances of each country:

- The Dakar Free Industrial Zone is controlled by a parastatal, the Societe d'Amenagement et de Promotion de la Zone Franche Industrielle de Dakar. The agency operates as an independent body, under the supervision of the Ministry of Finance.

- Initially, the government-owned Development Bank of Mauritius dominated the construction of industrial estates. By 1987, however, while three out of seventeen industrial estates in Mauritius were managed by the Development Bank, seven operated by MEDIA (a private non-profit authority that is composed of representatives of the public and private sectors), and seven others by private sector groups on a for-profit basis. In addition, as noted above, firms operating anywhere on the island can qualify for EPZ incentives.

- Turkey has utilized the "build-operate-transfer" approach to zone infrastructure development whereby the government leases developed land for private parties to build and operate and transfer the zone at the end of a defined period to the public sector.

- In Egypt, the four zones are owned and operated by the parastatal General Authority for Investment and Free Zones; private industrial estates may also house EPZ firms which may locate anywhere in the country.

2.52 Unlike most of the EPZs in the Far East whose affairs are regulated by the same bodies that own and manage them, separate regulatory bodies administer the EPZ regimes of the Africa/Middle East region. Several basic models include the following:

- In Turkey, the authority to approve EPZ user applications and provide all other operating permits and licenses is given to on-site 'Zone Directorates,' an overall regulatory body that has predominantly private sector representation.

- In Mauritius, the regulation of the EPZ regime falls broadly under the responsibilities of the Ministry of Industry, through its majority representation on the Industrial Coordination Unit, an inter-ministerial group that approves all investor applications. The experience with the Industrial Coordination Unit has been largely negative, characterized by bureaucratic delays, despite the substantial assistance provided the investor by the Mauritius Export Development and Investment Authority.[4]

- The General Authority on Investment and Free Zones regulates the Egyptian EPZ regime. This organization was started in the 1970s with a small professional staff, but has now grown to over 3,000 employees -- 1,300 of whom are overseeing the four EPZs. As a result, the organization is characterized by extreme inefficiency; delays of 1 to 2 years for EPZ investment approval are not uncommon.

3. Caribbean Basin/Central American Export Processing Zones

a. Overview

2.53 Since the 1960s, a total of 43 EPZs have been established in 14 of the 31 countries comprising the Caribbean Basin. In 1988, these zones together directly employed over 200,000 people, while generating many additional jobs indirectly. As shown in Table 2-13, the growth of regional EPZs since 1975 has been impressive. In nominal terms, the number of zones increased by a compound annual growth rate of 19 percent between 1975-88; total direct employment increased annually by 24 percent; and total "under-roof" industrial space absorbed per annum exceeded 20 percent. From 1975 to 1988, a total of about 1.4 million sq.m. of EPZ space was constructed and fully leased, averaging over 110,000 sq.m. annually.

2.54 The distribution of EPZ activity in the Caribbean/Central American region is shown in Table 2-14. As indicated, regional EPZ activity is concentrated in a few countries: Mexico, with some 90 industrial estates with EPZ-style incentives, generating over US$6 billion in annual exports; and the Dominican Republic with 16 EPZs, 120,000 workers and US$520 million in annual revenues. Other significant EPZ locations include Jamaica, Costa Rica, and Barbados.

2.55 Although impressive in aggregate, the performance of individual countries has varied considerably. The number of jobs created in the region's EPZs ranges from over 120,000 in Dominican EPZs, to less than 400 in the Guatemalan zone. The difference in export earnings is even more substantial. In the Dominican Republic, for instance, EPZ exports account for well over 25 percent of total non-traditional export earnings; in Guatemala the US$15 million ZOLIC EPZ houses

---

[4] The entire regulatory and administrative framework for EPZ approvals in Mauritius is currently being revamped and streamlined into a true, one-stop-shop.

TABLE 2-13
GROWTH OF CARIBBEAN/CENTRAL AMERICAN EPZS
(1975-88)

	1975	1988	Compound Annual Growth (%)
Number of EPZs	5	41	19
Total Direct Employment	15,000	200,750	24
Total "Under-Roof" Industrial Space Leased (square meters)	167,225	1,557,000	20

Source: Data compiled by TSG.

TABLE 2-14
PROFILE OF CARIBBEAN/CENTRAL AMERICAN EPZ PROGRAMS

	Date Started	No.of Zones	Direct Employment	Annual Exports
Bahamas	1980	2	8,000	n/a
Barbados	1982	11	20,000	n/a
Costa Rica	1977	4	4,000	US$ 20m
Dominican Rep.	1965	16	120,000	US$ 520m
El Salvador	1973	1	3,000	n/a
Guatemala	1971	2	400	n/a
Haiti	1983	1	50,000	n/a
Honduras	1972	2	30,000	n/a
Jamaica	1971	4	90,000	US$80m
Mexico	1965	90	400,000	US$6b
Panama	1972	1	12,000	n/a
Puerto Rico	1979	3	4,000	n/a
Other	--	6	6,000	n/a
Total:		**143**	**747,400**	

Source: Data compiled by TSG.

only two manufacturing firms, and accounts for less than five percent of the country's annual exports.

2.56 One of the most notable developments in the region is that the private sector is playing an increasingly important role in EPZ ownership and management. Zones such as San Cristobal and San Isidro in the Dominican Republic; the Cartago zone in Costa Rica; and Freeport in the Bahamas have consistently out-performed their publicly subsidized counterparts, both financially and economically. EPZ users in the Caribbean Basin have shown a willingness to pay higher rental rates if assured of responsive property management, higher aesthetic standards, better maintenance of infrastructure, and fewer delays in building construction. This trend is corroborated in zones throughout the Caribbean Basin, where occupancy rates in private zones are significantly higher than in public zones.

2.57 In response to the growing demand from various non-traditional industrial and service sectors, countries in the Caribbean Basin are rapidly expanding the size and number of existing EPZs, as well as removing impediments to the construction of others. Reacting to investor waiting lists of two years or more, EPZs in the more established centers such as the Dominican Republic and Jamaica are now undergoing rapid expansion.

2.58 In contrast, several public zone programs have had mixed results, achieving only marginal returns in terms of foreign exchange earnings and employment relative to private sector counterparts. Ironically, many of the following zones have been in operation longer than more successful private zones:

Guatemala. ZOLIC, Guatemala's only EPZ, has evidenced poor performance by regional standards since the commencement of operations in 1973. Plagued by little or no promotion, poor facilities development and maintenance, and a lack of suitable labor, the zone has been primarily utilized for transshipment and warehousing activities. In an effort to modernize the program, the government has created a public-private commission to develop an ambitious plan for support of private EPZ projects, but implementation of such initiatives has not yet occurred.

Honduras. Created in 1976, the Puerto Cortes EPZ (PCFZ) has achieved respectable results; the zone has leased all available space, primarily to apparel manufacturers, and employment now approaches 3,000. The public zone program has failed, however, to attract and absorb increasing regional demand for SFB space. In recognition of the vast opportunities lost to other EPZ locations, the government has designated the first private EPZ site in Villanueva, near San Pedro Sula, and the zone was scheduled to begin operations in 1989; several other private zone projects are being planned.

Costa Rica. Unlike the private sector Cartago EPZ, Costa Rica's sole operating public zone, Moin, has only three firms at present. Lack of interest in Moin stems from its undeveloped infrastructure, locational isolation, perceptions of poorer labor quality, inadequate promotion, and unresponsive public management. The development of the Santa Rosa zone has languished for years and does not yet have any operating

tenants. The owner of these public sector zones -- the Corporacion de la Zona Franca -- has divested portions of these properties and is seeking to privatize the remaining area.

2.59 In response to growing demand from U.S. and Far Eastern investors, the number of Caribbean and Central American countries sponsoring EPZs is growing. Countries like Belize, El Salvador and Trinidad & Tobago are at various stages of EPZ development; more EPZs are being developed in the Dominican Republic, Jamaica, and Costa Rica.

b. Historic and Current Economic Contributions

2.60 **Dominican Republic**. The Dominican Republic has the Western hemisphere's most active EPZ program, with sixteen operational zones, six others under construction, and an additional ten zone projects in a formative stage. The Dominican Republic has the most dynamic EPZ program in the region, accounting for 70 percent of all EPZ exports, 67 percent of all EPZ workers, and 48 percent of all the companies in the Caribbean Basin. (See Table 2-15.)

2.61 Dominican zones support a range of export operations ranging from agro-industry (cigar manufacturing) and apparel to electronics assembly and data entry. EPZ development in the Dominican Republic has had a dramatic impact on exports, employment, and earnings. Total zone employment has more than quintupled in the last six years, rising from 20,000 workers in 1984 to an estimated 120,000 in 1989, accounting directly and indirectly for over eight percent of national employment and over half of all manufacturing jobs. From a low of three firms operating in EPZs in 1969, the total number of firms has risen to some 276 in 1989, and 77 firms have been added in the last two years alone. U.S. investment in the Dominican EPZs since 1984 has totalled US$271 million.

2.62 The growth of EPZ exports between 1975 and 1987 averaged nearly 24 percent annually. In 1988 alone, the value of EPZ exports rose by 61 percent to US$520 million, accounting for 55 percent of total exports. Formal estimates of net foreign exchange earnings of the zones in 1988 exceeded US$130 million; informal estimates place the true figure at about US$200 million. Significantly, this growth occurred while all other national exports evidenced an average negative rate of growth of one percent per year for the same period. A final contribution by the EPZ program is the reduction of the Dominican Republic's reliance on sugar exports as a source of foreign exchange -- from almost 50 percent in 1981 to less than 20 percent in 1988.

2.63 Innovative zones include San Cristobal, hosting such "blue-chip" firms as GTE, Baxter Travenol, and others; and San Isidro, a combination office park/EPZ offering customized facilities for the information services sector and other industries. In early 1987, the country's telephone company CODETEL (a subsidiary of GTE) announced the establishment of the region's first privately owned teleport earth station. The facility will be utilized to attract telecommunications-intensive operations and service industries.

TABLE 2-15
GROWTH OF DOMINICAN EPZS

	No. of EPZs	Employment	Exports	No. of Firms
1970:	1	126	n/a	3
1974:	3	3,244	n/a	28
1978:	4	11,545	US$ 37m	60
1982:	4	18,075	US$ 74m	110
1986:	6	40,000	US$238m	140
1988:	16	120,000	US$520m	276

Source: Data compiled by TSG.

2.64 Some 60 percent of the EPZ firms produce textiles. While the remaining firms also produce traditional EPZ-type exports, such as shoes and electronic components, there are also two data processing enterprises, and other "high-tech" operations. The Dominican Republic has been one of the main beneficiaries of foreign investment in the Caribbean Basin. In particular, the nation is a prime beneficiary of the U.S. Caribbean Basin Initiative (CBI). In addition, the Dominican Republic has just been accorded preferential access to the European market under the Lomé Convention.

2.65 To date, there is very little local sourcing by EPZ firms in the Dominican Republic. In addition, the vast majority of EPZ companies are foreign, but 11 percent represent local investors, while an additional four percent are joint ventures. The average value-added component of Dominican zones is only 25 percent, of which 22 percent is labor content and only 3 percent is comprised of locally sourced goods. This is in marked contrast to countries like Taiwan where 45 percent of the inputs are of Taiwanese origin and the Taiwanese value-added ratio is about 67 percent.

2.66 **Mexico**. In contrast to the relatively recent development of EPZs in the Caribbean Basin, the Border Industrialization Program (BIP) in Mexico offering EPZ-style incentives to the so-called "maquiladora" (assembly) firms has been in place for over 20 years. As originally conceived, the BIP was an attempt to promote "twin plants" along the Mexican-U.S. border, in which labor-intensive operations would be performed in Mexico, while more capital and technology-intensive tasks would be performed in "sister" plants on the U.S. side.

2.67 Since inception, the overall expansion in manufactured exports from the border zone has been impressive. As shown by Table 2-16, the number of firms has grown steadily from 16 in 1970 to 1,660 in 1989, employing close to 400,000 workers. The 1986 level of maquiladora exports into the U.S. reached US$6.7 billion, representing net foreign exchange earnings for Mexico estimated at

US$1.6-1.8 billion. This has placed the maquiladora industries second only to oil as a foreign exchange earner, and their contributions are rapidly increasing compared to oil's absolute and relative decline.

2.68 Over time, the character and composition of the border program has changed. Originally dominated by the textiles/apparel, electronics and toy manufacturing sectors, investment has diversified to a broad range of products. In 1987, electronics accounted for 27 percent of value-added; electrical machinery and supplies 18 percent; transportation equipment and supplies (chiefly components for the auto industry) 23 percent; furniture and other products six percent; and textiles and toys less than five percent each. Mexico has also attracted substantial flows of investment from Japanese and European firms active in the U.S. market. Most often through U.S. subsidiaries, these firms have set up assembly operations in Mexico to access the U.S. market, often using a mix of U.S. and other-source components, but with substantial savings and increased competitiveness compared to final assembly either in the United States or the home country.

TABLE 2-16
MEXICAN MAQUILADORA HISTORICAL STATISTICS

Year	Plants	Employees (thousands)
1970	16	--
1974	455	75.9
1978	457	90.7
1982	588	122.5
1986	987	268.4
1988	1,333	350.2
1989 (est.)	1,660	400.0

Source: Data compiled by TSG.

2.69 The impact of the maquiladoras on the northern region of Mexico has been substantial. For many years a depressed region within the country, the border region is now one of the most prosperous. Wage rates in the border zone have recently increased to levels 50 percent higher than those prevailing in other regions, and annual turnover among employees is approaching 100 percent. Both of these factors indicate a competitive environment for the recruitment of workers in assembly industries. Much of the new investment is now going to regions outside the border zone, as firms attempt to locate in lower-cost areas in the interior where labor is more plentiful. While the interior areas immediately adjacent to the border have been the principal beneficiaries of this gradual geographic dispersion, the Yucatan and even La Paz have also attracted a number of maquiladora firms.

2.70 The BIP has developed in the context of an entire region with individual firms operating under privileged customs status, and not within defined Export Processing Zones as such. The designation of maquiladora status within the border region is granted to specific companies rather than traditional EPZ's. Nevertheless, industrial estates have played an important role in providing factory space and services for the maquiladora industries. Although public sector industrial estates are to be found, the government has encouraged private sector participation and private groups have taken the lead role in establishing industrial facilities. While aggregate data on industrial estates in the maquiladora industries are not regularly compiled, estimates from 1979 revealed 16 public sector industrial estates with 37,000 employees; in 1986 as many as 70 private industrial estates were in operation serving the maquila sector, with over 230,000 employees, accounting for the vast majority of this sector. This dominance by the private sector is likely to continue, as they have clearly demonstrated the ability to be responsive to investor needs.

2.71 The success of the program has encouraged its expansion and elaboration. Maquiladora firms have by and large been exempted from much of the restrictions placed on foreign investment in Mexico in the years since the program's inception. The program was reconfigured in the late 1970s to allow location outside of the border area, and to allow limited sales from maquiladora firms to the local market, without the loss of incentives. Through a recently announced debt swap program, investments in maquiladoras are eligible for financing through a debt/equity conversion. This continuing support from the government for the program has helped to ensure its growth.

2.72 **Costa Rica**. Unlike Mexico and the Dominican Republic, Costa Rica is a relatively recent addition to the EPZ community, having begun its program in 1981. The contribution of EPZs to the Costa Rican economy has been less substantial than that of its partial export schemes including temporary admission and export contract. In 1987, 35 EPZ companies directly employed some 4,000 workers and generated about US$20 million in exports. As in the case of the Dominican Republic, the Costa Rican zones have not been very effective in creating backward linkages. Approximately nine percent of EPZ imports are locally sourced, and the local value-added of EPZ exports is about 31 percent.

2.73 The Cartago EPZ, the nation's most successful, has grown rapidly in the past two years. The zone offers users a wide range of support services, and provides on-site training programs in cooperation with the National Training Institute. The SARET EPZ in Alajuela, recently operational, has experienced a lower absorption rate than Cartago, and to date has only eight tenants. Government authorities, however, plan to allow private developers a leading role in the construction of EPZ facilities, and have approved three additional private EPZ projects.

c. Evolution of the EPZ Policy Regimes

2.74 **Dominican Republic**. The impressive growth of the Dominican EPZs has occurred in the absence of any unified EPZ legislation.[1] In 1968, basic legislation was enacted allowing firms producing 100 percent for export to locate in EPZs. These firms qualified for a variety of incentives that reduced the policy distortions resulting from import protection and an overvalued exchange rate. This was supplemented by a law in 1969 enabling EPZ firms to hold foreign currency accounts, as shown in Table 2-17.

2.75 These measures proved attractive to export firms, and the first EPZ, privately owned and operated by Gulf + Western, opened in 1969. At the same time, however, the government was also encouraging import substitution industries facilitated by restrictive quotas, high tariffs, and a two-tier exchange rate system that was biased against exporters. Thus, only 31 percent of the private investment between 1968 and 1977 was in export-oriented firms, and even today, over 40 percent of the nations' manufacturing is concentrated in the sugar industry, and much of the remaining capacity produces for the domestic market.

2.76 Nonetheless, growth of EPZ exports averaged nearly 24 percent per year from 1975-87. In particular, the replacement of a two-tiered exchange rate with a

TABLE 2-17
EVOLUTION OF THE DOMINICAN EPZ REGIME

Year	Measure
1969	La Romana Free Zone is established under the provisions of Law 299 oriented to wholly export-oriented firms. The EPZ is developed and operated by the U.S. Gulf + Western corporation.
	Law 432 is passed amending Law 299 and exempting EPZ firms from the requirement to surrender all foreign exchange earnings to the Central Bank within two days of receipt. EPZ firms are allowed to independently hold foreign currency accounts in the Central Bank.
1982	EPZ firms allowed to independently maintain foreign accounts in commercial banks.
1983	Locally owned EPZ enterprises are allowed to receive the tax holiday previously limited to foreign-owned firms.
1985	Adoption of a freely floating exchange rate.

Source: Information compiled by TSG.

[1] An extensive EPZ law was approved in January 1990.

free market rate in 1985 led to large increases in EPZ exports. The rationalization of the foreign exchange regime provided the critical impetus for the current success of the nation's EPZ program; practically all the incentives and conditions were in place prior to 1985, but they were insufficient to overcome the exchange-rate bias against exports. Following the change in the currency regime, EPZ exports grew 20 percent in 1986, after increasing by only four percent in 1985, and have increased by larger percentages in the 1987-89 period. Similarly, the number of EPZ projects reflected the improved exchange rate. The number of EPZs remained constant at four from 1976 to 1985; between 1985 and 1989, a further 12 opened, and 13 more are authorized or under construction. In 1988, EPZ exports accounted for 96 percent of total manufactured exports.

2.77 **Costa Rica.** EPZ activity in Costa Rica has undergone three stages of development. The first stage began in 1981, when EPZ legislation was first introduced. The incentives offered investors were largely comparable to those offered by other Caribbean Basin zones with three major exceptions. the program did not allow EPZ firms to have foreign exchange accounts; privately owned and operated zones were prohibited; and the national goal of regional development placed the zones in non-competitive locations with relatively undeveloped infrastructure. For these reasons, the two Export Processing Zones that were established, at Moin and Santa Rosa, attracted little investor interest.

2.78 In 1984, after viewing the disappointing occupancy rates in the two zones, the government ushered in the second stage of Costa Rica's EPZ program by amending the EPZ law. EPZ users were given the right to hold foreign currency accounts, and in 1985, the law was further modified to allow privately owned and operated Export Processing Zones. The Cartago Industrial Park was thus begun. The zone offered the same incentives as the two government-operated zones, but also had the additional advantages of private ownership and operation, an excellent location, and on-site Customs inspection. Occupancy levels of this zone grew, while those at Moin and Santa Rosa continued to languish. In addition, three factory-specific sub-zones were authorized, based on specific locational needs.

2.79 The third stage began in 1987, when the success of the Cartago zone led to further interest in zone development and the granting of four more zone designations. Development of these zones has been proceeding at an uneven pace. A positive sign, however, is that these projects are designed to be upscale parks with special services to better allow them to attract high technology and service-oriented firms. This development is a highly positive one which takes advantage of Costa Rica's relative strengths, and which sets the stage for further diversification of the nation's EPZ industries.

2.80 Until recently, the Costa Rican EPZ growth has been limited by the unusual strength of the country's two other export promotion schemes. Firms under the Temporary Admission Program and Export Contract Program have had equivalent -- or even superior -- incentives to EPZ firms. The Temporary Admission Program had in 1988 four times as many firms and exports, and almost six times as many workers as the EPZ regime. Similarly, the Export Contract Program, has outperformed the EPZ program. This program had exports of more than US$273 million in 1986, included 380 companies, and accounted for more than 36,000 jobs.

2.81 The incentives offered by the EPZ and the Temporary Admission Program are roughly similar, but the Temporary Admission Program for a number of years had several advantages over the EPZ program. These included the right of firms to locate wherever they desire, a one-stop approval process which made it easier for non-zone firms to gain approval; and lower land and building prices. The regime for the Export Contract Program is not strictly comparable to the EPZ program, for participating companies must have 35 percent local value-added, and most of the companies are in rural areas. The success of this program has been strongly influenced by the 15 to 20 percent tax credit offered. While the Export Contract Program is scheduled to end in 1996, Costa Rica's EPZ program must offer distinctive and more advantageous incentives if it is to outperform these alternative regimes.

d. Comparison of the Incentives Packages

2.82 The EPZs of the Caribbean/Central American region offer some of the most liberal and comprehensive packages of incentives in the world as shown in Table 2-18. Corporate income tax exemptions range from a six-year holiday in Costa Rica, to 20 years in the Dominican Republic, and in perpetuity in Jamaica and Honduras. Imports of capital equipment, spare parts, and raw materials are tax and duty-free in all countries, and exports of finished products are unrestricted. The EPZs all offer complete control over foreign exchange earnings, and unrestricted repatriation of profits and invested capital. By contrast, the Mexican maquiladora program -- while offering many of the same incentives -- does not offer a corporate income tax holiday.

2.83 Important differences exist, however in terms of local market sales, foreign and local ownership of EPZ enterprises and in the length of the EPZ investment approval process. Sales to the domestic market are generally restricted to 20 percent of annual production in most regional EPZs, but important differences exist. Costa Rica offers an extremely generous level of sales to the domestic market, up to 49 percent of total output; Jamaica, on the other hand, does not allow sales to the local market. Unlike most of the other EPZs, Jamaica also restricts its EPZ regime to foreign firms and does not allow foreigners to own land or buildings within the EPZs. Perhaps the most flexible regime is Costa Rica's which -- like the Dominican Republic, Mexico, and other countries -- allows individual factories to be designated as EPZs regardless of location. Unlike most other locations however, the Costa Rican industrial parks allow firms operating under several regimes to locate within them. The timetable for approval of investments is slightly longer than in the Far East, averaging about 60 days in the Caribbean/Central American region.

e. Zone Management and Regulation

2.84 **Ownership and Management**. There is a strong and accelerating trend towards private ownership and operation of EPZs in the Caribbean Basin. In countries like the Dominican Republic, Jamaica, Costa Rica, Honduras, El Salvador and elsewhere, older public sector EPZs are being supplanted by private zones that operate on a profit-making, cost-recovery basis. The widest range of potential

TABLE 2-18
COMPARISON OF EXPORT INCENTIVES IN CENTRAL AMERICAN AND CARIBBEAN COUNTRIES

	Barbados (Industrial Estates)	Costa Rica (EPZ)	Curacao (EPZ)	Dominican Republic (EPZ)	El Salvador (EPZ)
Corporate Income Tax Abatement	100% exemption in perpetuity	2% tax on export sales only; 27-39% domestic sales tax	100% exemption for 6 years; 50% exemption for 4 years following	100% exemption for 8-20 years	100% exemption for10 years
Capital/Profits Repatriation	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Not explicit
Duty Treatment for All Imports and Exports	100% exemption	100% exemption	100% exemption	100% exemption	100% exemption
No. of Days To Receive Approval	30-60	45-60	Not available	60	45-90
Tax on Dividends	100% exemption for non-residents only	100% exemption	100% exemption	100% exemption	100% exemption
Restrictions on Foreign or Local Ownership	None	None	None	None	None
Sales To Local Market	Not allowed	49% of total output	25% of total output	20% of total output	Variable; decided on a case-by-case basis
Management of Foreign Currency	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Controlled

Source: Data compiled by TSG.

TABLE 2-18 (Continued)
COMPARISON OF EXPORT INCENTIVES IN CENTRAL AMERICAN AND CARIBBEAN COUNTRIES

	Guatemala (EPZ)	Haiti (EPZ)	Honduras (EPZ)	Jamaica (EPZ)	Panama (EPZ)
Corporate Income Tax Abatement	100% exemption for 12 years	100% exemption for 8 years; scaled reductions after holiday for 5 years	100% exemption in perpetuity	100% exemption in perpetuity	2.5-8.5% tax rates for export sales; additional concessions if 80% production exported
Capital/Profits Repatriation	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted
Duty Treatment for All Imports and Exports	100% exemption	100% exemption	100% exemption	100% exemption	100% exemption
No. of Days To Receive Approval	Not available	Not available	35-40	30-60	Not available
Tax on Dividends	100% exemption	100% exemption	100% exemption	100% exemption	100% exemption
Restrictions on Foreign or Local Ownership	None	Foriegn owners cannot lease real property	None	None	None
Sales To Local Market	Limited access	Not explicit; venture must involve local partner	Unrestricted	Not allowed	Unrestricted
Management of Foreign Currency	Unrestricted	Not available	Unrestricted	Unrestricted	Unrestricted

Source: Data compiled by TSG.

EPZ ownership options is found in the Dominican Republic, where EPZs occur in public, fully private, and private, not-for-profit forms. Public sector zones are both directly owned and managed by the government (as in the case of Taiwan and South Korea) and by independent, parastatal corporations. Over two thirds of the zones, however, are privately owned, as the Dominican private sector has recognized that efficiently operated EPZs can be a profit-making activity. While the first EPZ projects in Costa Rica were public sector operated, all new zones are privately owned and managed. In Jamaica, the first two EPZs are owned by an autonomous public corporation, under direction of the Port Authority of Jamaica.

2.85 Costa Rica and the Dominican Republic provide illustrations of contrasts between public and fully private sector zones. Foreign investors will pay a premium of as much as US$1.20 per square meter per month (sq.m./month) to locate in privately owned Costa Rican Export Processing Zones such as Cartago or Alajuela rather than locate in the public EPZs. In the Dominican Republic, the differential is even greater between public and private zone rental rates. Investors will pay more than US$4.00/sq.m./month to locate in the private zones of San Cristobal and San Isidro, when space can be rented in governmental zones such as San Pedro de Macoris for approximately US$1.50/sq.m./month. A similar situation is found in Mexico where only 20 private industrial parks account for well over half of total maquiladora employment.

2.86 **EPZ Regulatory Bodies.** The need for a separate entity regulating EPZ development in each of the Caribbean Basin programs discussed is acute, given the large number of zones in general, and the increasing number of private zones in particular. In most countries of the Caribbean Basin, the regulatory function of approving new EPZs, evaluating the applications of potential EPZ enterprises and the like, is performed by a unit placed within a government ministry. A typical example is the Dominican National Council of Free Zones which is within the Ministry of Economy. The efficiency of these regulatory entities depends on the power of the respective ministry and its relations with other ministries. In cases such as El Salvador, even though the Ministry of Foreign Trade is responsible for regulating the EPZs, investment approvals must be received from the Ministry of Economy and the Ministry of Finance. Delays of several months are possible.

2.87 There is a strong move in most of these EPZ locations to centralize and streamline the regulatory bodies into true one-stop-shops, with a representative office on-site. A notable example of the new type of regulatory body that is evolving is the Free Zone Corporation of Costa Rica, which is an independent, limited liability company that is the sole regulatory body for the EPZ regime. The corporation has a mixed private/public sector board of directors, and is financed by contributions from the public and private sectors, as well as by a levy on the area of under-roof EPZ space rented annually. The organization itself does not own or operate EPZs directly or indirectly and is purely a regulatory body.

C. LESSONS LEARNED: GUIDELINES FOR EFFECTIVE EPZ DEVELOPMENT

1. EPZ Policy Framework

2.88 As discussed previously, two elements are of critical importance to the success of free zone incentive programs. These are the substantive nature of the inducements, and the procedures for granting access.

a. Types of Incentives Offered

2.89 The incentives and regulatory environment in a typical EPZ have evolved over the years from the simple Customs abatement associated with commercial free zones. With the development of EPZs, an attractive fiscal regime (normally in the form of exemption from local taxation or a tax holiday) became an important aspect of improving the cost savings available to manufacturers. In addition, other measures, both in terms of fiscal incentives and regulatory relief, have become a part of the regulatory framework normally found in EPZs.

2.90 As indicated by our analysis, the principal benefits offered by the leading EPZ programs worldwide include:

- **Full exemption from Customs duties, import taxes and other levies on imported capital equipment.** Although some countries exempt capital goods from import duty for priority industries, the norm for EPZs is that all imports of capital equipment to be used in an export business in the free zone are exempt. This blanket exemption normally excludes any goods such as motor vehicles which, although used for the business, are taken out of the zone.

- **Full exemption of Customs duties, import taxes and other levies on all imports of raw materials, intermediate goods, and supplies used in manufacturing in the zone.**

- **Tax relief, including corporate tax holidays for a defined period.** Some zones extend tax holidays in perpetuity; others impose a nominal tax rate on corporate profits or fees and other assessments to gain public revenue from zone firms. The average length of the tax holiday in the leading EPZs is about 10 years. The important factor is that the net effect of taxation on a firm's operating costs not be so great as to serve as a disincentive, especially with respect to other competing locations.

- **Unrestricted repatriation of invested capital and profits.** An important aspect of most free zone regimes, repatriation is often controlled in some manner in countries which have had little experience with foreign investment. With few exceptions internationally, this privilege is granted to all foreign investors in EPZs.

- **Freedom from exchange controls.** Incentives are made meaningless if access to foreign exchange is controlled in a restrictive manner by

the Central Bank; zone incentives generally ensure access by exporters to foreign currency.

- **Regulatory relief.** Among the most important aspects of EPZ regulatory regimes is the simplification and streamlining of the various approvals, permits, licenses, etc., required for doing business. This regulatory relief normally extends from expedited investment approval and qualification as a free zone company to the issuance of expatriate work permits, export licenses, and routine administrative requirements.

- **Ability to sell a small percentage of production locally.** Although EPZs are targeted at export industries, these firms are producing goods which also often have a local market. It is common for zones to allow the sale of a small (usually 10 to 20 percent) share of their production locally, paying full duty as imports. This is more of a convenience to the manufacturer in that it allows a firm to sell locally leftover lots, imperfect goods, etc., without having to re-export them, often at a loss. Penetrating local markets, except in this manner, is not normally an important factor to most firms in EPZ industries. It should be noted that Taiwan and South Korea until very recently did not allow significant local market access.

2.91 These are normally considered the basic incentives necessary to attract foreign investors to an EPZ. The lack of one or more of these elements has crippled some EPZ programs from the start. In Costa Rica, the original legislation made no provision for exemption from exchange restrictions. Shortly after its adoption, controls on foreign exchange during balance of payments crises persisted, and the law was amended as part of an effort to attract investors.

2.92 The combined effect of the fiscal incentives is more important than the nominal length of the tax holiday or the specific tax rate imposed on export firms. Successful EPZs have a range of tax relief policies. Hong Kong, Mauritius, and the Special Economic Zones of the People's Republic of China have instituted low, "flat rate" taxes of 15 to 20 percent on corporate earnings. The generosity of tax incentives does not appear to be highly correlated with investor response; although the tax incentives of Malaysia, Hong Kong, Taiwan, and the Dominican Republic are less liberal than those of Egypt, for example, foreign investors have found the former countries more attractive because of their predictable and standardized treatment of foreign private investors.

2.93 The value of fiscal benefits and the affect that they have on investor location decisions varies greatly from firm to firm. On the one hand, for larger multinational companies operating offshore subsidiaries on a consignment basis, the value of a corporate income tax holiday is minimal. Profits can also be reduced in one country by transferring them to holding companies in low-tax countries. On the other hand, tax holidays are very important for the smaller investor, and especially for local firms.

2.94 In addition to these crucial incentives, various other mechanisms are also commonly associated with EPZs, including training subsidies, accelerated

depreciation and other capital cost-reducing incentives. These incentives sometimes have unintended results. A lower training wage for an apprenticeship period has resulted in an abnormal turnover in some EPZs as firms try to take advantage of the lower wage. High accelerated depreciation schemes and investment tax credits have sometimes attracted overly capital-intensive production to labor-surplus EPZs. In general, successful EPZs are characterized by transparent incentives that confer neutrality and enhance (not distort) market forces.

b. Modes of Implementation

2.95 As demonstrated by such countries as Mauritius, Mexico and the Dominican Republic, EPZ policies can be applied either to a geographically defined area (e.g. an industrial estate) or to individual firms engaged in export activities regardless of location.

2.96 Geographically delineated EPZs -- such as the EPZs of Taiwan -- are typically configured as industrial estates surrounded by a fence to prevent leakage of duty-free goods into the surrounding Customs territory. This approach to EPZ development has several advantages from the point of view of a sponsoring country. It establishes a concrete location to promote to overseas investors, places the foreign firms under continuing Customs supervision, and allows for cost-effective site development, infrastructure, and factory construction. This type of classic EPZ regime is normally easier to administer, especially for countries with limited institutional capabilities and familiarity with export industries. From the point of view of the export industry, such a zone normally imposes fewer administrative requirements, to the degree that the monitoring function of Customs and other agencies is facilitated by the location in a zone.

2.97 Other countries have had success with the alternative policy of applying EPZ incentives to individual factories without regard to their geographic location. Advantages of this approach can include diffusing economic development activities more widely in a country, and reducing the number of full-time governmental personnel dedicated to monitoring EPZ-designated firms. Disadvantages may include placing strains upon Customs capabilities to conduct audits and identify shortcomings in corporate record-keeping; imposing more costly site improvement and infrastructure development costs as a result of decentralized industrial locations; and foregoing a highly defined and marketable "product" in foreign investment promotion initiatives. In Mauritius, the costs of their development strategy are only now being felt: some 50 percent of EPZ firms do not even have telephone connections.

2.98 In practice, these two approaches are not mutually exclusive. Most developing countries with successful EPZ programs -- including Mexico, Mauritius, and the Dominican Republic -- are now balancing industrial estate EPZ projects with portable factory-specific EPZ designations. A mixed approach appears to maximize foreign investment inflows, by offering foreign investors the ability to choose the framework they find most suitable. The difference in application depends on whether the option of locating outside a defined zone is available without specific application, or is only granted as an exception. The presumption of duty-free entry of goods destined for an EPZ, the administrative

ease of policing a defined area, and the fiscal advantages of not having to post bonds or pre-pay duties for refunds, however, all give the geographically defined EPZ advantages.

c. Access to Zone Benefits

2.99 Regardless of whether EPZ incentives are applied only within a defined area or are available to all exporting firms, the regime must be applied in a straightforward and predictable manner. The vast majority of foreign investors are highly sensitive to the simplicity and automaticity of incentives. A number of companies desiring to establish operations in EPZs are not large multinationals, but rather are small- and medium-sized firms with little prior experience producing offshore, particularly in the apparel industry. Major multinational corporations can more readily afford the delays that may accompany negotiations over incentives with a government; small investors seldom have the resources to embark upon lengthy and uncertain discussions.

2.100 In considering an EPZ location, foreign investors look carefully at the experience of other firms in obtaining incentives. Although a given EPZ may have attractive incentives on paper, it can quickly gain notoriety if foreign investors in practice encounter a myriad of uncertainties and delays when seeking to obtain their benefits. Many governments have preferred to retain a high degree of discretionary control over the investment approval process in particular, and some even vary the degree of fiscal incentives granted according to their evaluation of the desirability of the investment. Zones in Zaire, the People's Republic of China, Honduras, and Senegal have deterred prospective foreign investors by a time-consuming, complex, and uncertain application process. Recently enacted EPZ legislation in Costa Rica obliges prospective investors to locate only in remote areas, unless a feasibility study demonstrates their need for location in the Central Valley. In Uruguay, similarly, EPZs are not allowed to extend incentives to foreign investors who might compete in world markets against established Uruguayan firms.

2.101 In Tunisia, the degree of discretionary authority assumed by the Industrial Promotion Agency and the delays and uncertainty associated with the approval process prompted a wholesale reevaluation of its role and procedures in the last year. Subject to normal review, 100-percent export industries now require no approval or screening, and the application process is really just one of registration. The Agency has a statutory limit of 30 days in which to review and decide the eligibility of firms for other types of incentive programs. This stark revision of its authority was adopted as part of a widespread series of measures to improve the implementation of what was otherwise a relatively attractive export manufacturing regime, based on EPZ-like incentives available to firms locating anywhere.

2.102 Foreign investors remain acutely sensitive to the actual degree of government control encountered after they have obtained EPZ status. Official or unofficial interventions by public sector organizations into the day-to-day operations of established zone export industries can prompt firms to disinvest, and jeopardize the ability of an EPZ to attract new inflows of foreign investment.

2.103 In summary, a policy of retaining discretionary control over the eligibility and operations of EPZ firms can be an anathema to export-oriented investors, due to the uncertainty created, the inevitable delays, and the need for lengthy project proposals. One of the inherent advantages of an EPZ program is that it specifically delineates a sector -- export industry -- with readily defined criteria for eligibility under the incentive regime, so that there should be no need for extensive evaluation and review once the good standing of a firm is verified. In this manner, the very existence of a EPZ regime is an advantage in promoting foreign investment, and in stimulating domestic investment in the export sector.

2. Ownership and Management of EPZs

2.104 A wide range of alternative models for EPZ ownership and management have been successfully implemented around the world, ranging from fully public sector owned, financed and developed zones on the one hand, to 100 percent private ownership and management on the other. In general, three types of models are found: fully private zones; mixed public/private zones; and fully public sector zones.

2.105 **Fully Private Zones**. The experience of most recent EPZ sponsoring countries indicates a preference among foreign investors for zones that are developed and managed on a completely private basis, when a choice exists. The preference for private zones has arisen from disparities between the public and private sector in the responsiveness of zone management organizations, as well the variety and quality of property management services offered EPZ tenants.

2.106 As seen above, in numerous EPZ locations around the world -- including Malaysia, the Dominican Republic, and Mexico -- foreign investors are willing to pay higher lease rates for private EPZ facilities rather than locate within public zones. Because private zones are run on a cost-recovery basis, they tend to be fully responsive to tenant needs, and provide a wider range of property management services and amenities including specialized, on-site telecommunications facilities, health clinics, day care centers and business support services.

2.107 **Public/Private Partnerships**. A more active public sector role is found in the EPZ programs of Hong Kong, Turkey and the People's Republic of China, where a variety of public/private partnerships are being used to mobilize non-governmental funds and development expertise. The principal forms of such partnerships include: management contracting; joint equity ventures; long-term lease or sale of public lands to private developers; and "build-operate-transfer" agreements. Such approaches have the benefits of leveraging scarce public resources and creating more cost-effective, user-responsive zone operations.

2.108 **Fully Public Sector Zones**. Models of effective, fully public sector owned and operated zones can be found in the Far East NICs of Korea, Taiwan and Malaysia, where EPZs have been managed in a businesslike basis. Public sector EPZs in other countries have failed in large part because they were not run on a self-sustaining basis.

2.109 Notwithstanding the ability of some public sector organizations to manage EPZs effectively, a shift has occurred over the past decade from government EPZ models to private and mixed approaches to EPZ financing, development and operations. The trend has been especially evident in the new EPZ host countries such as Thailand, the Dominican Republic, and Mauritius. Many other countries such as Malaysia are privatizing their public zones.

2.110 Whether public or private, successful EPZs worldwide have been those that have been developed and managed on a businesslike basis. At a minimum, successful EPZs have been those that:

- **Charge economic rental rates.** Subsidized rates unnecessarily penalize a project and greatly compromise its financial integrity. EPZs must charge rates that are sufficient to meet all operating costs and allow for a reasonable return on invested capital.

- **Developed in pace with market demand.** EPZs have maximized their financial returns when physical development has been related to market realities. This has meant that the construction of the zone is conducted in phases, in pace with demand.

- **Enjoy financial and managerial autonomy.** Successful EPZs have been those that have streamlined administrative structures and autonomous control over their own financial resources. In most cases, this has meant that EPZs are operated as independent companies, with management accountable to a Board of Directors, and that zone lease revenues are under the control of zone management.

- **Maximize the role of the private sector.** Successful EPZs have also generally relied on private resources to offset deficiencies in the delivery of public services and infrastructure. This has meant that within an EPZ, the private sector has been allowed to construct factory space and provide electricity, telecommunications and other services.

3. Administration of the EPZ Package

2.111 There are strong regional differences in the administrative frameworks that have been adopted by countries in the implementation of their EPZ regime. In the Far East, the governments directly owned, operated and regulated their EPZs. In the Caribbean Basin/Central America, most zones have been developed by autonomous public and private corporations, and regulated by quasi-public bodies. A key global trend is the movement toward the establishment of "one-stop-shops" to consolidate and expedite government approvals. Applications for EPZ incentives, Central Bank authorizations, work permits for expatriate workers, and petty fee and tax payments are coordinated through a central agency.

2.112 The most successful one-stop-shops spare investors the confusions and often time-consuming delays of dealing with separate governmental departments; Ireland's export processing zone is considered a model. Few EPZ supervisory bodies in developing countries, however, have yet achieved comparable levels of

coordination and delegation of powers from interested ministries. Jamaica has recently moved to integrate the organizations involved in investment promotion, investment approval, export promotion, and the provision of physical facilities in EPZs and industrial estates.

2.113 In countries like Ireland, Honduras, Jamaica, Costa Rica, and Taiwan, EPZ administrative centers are completely autonomous and are in large part self-financing through levies on EPZ imports. In the newer EPZ locations, the need to guarantee responsiveness to investor needs has led countries to set up mostly private sector based EPZ regulatory bodies. In Fiji, the Board of Investment and Trade which regulates the EPZ regime is entirely private sector composed, but is funded by government. In a soon-to-be passed EPZ law in Cameroon, the EPZ regulatory body is a non-profit, limited liability corporation whose board of directors has six private and three public sector members, and is financed entirely by private firms.

4. Export Processing Zones and Broader Economic Policy Liberalization

2.114 EPZs have been extremely successful as a means to introduce market-oriented economic and institutional policy reforms. Due to the limited geographic area of the zone, liberalization of economic policies can be implemented in an EPZ without encountering widespread political opposition. Subsequently, the demonstration effects resulting from its success can strengthen the political and economic case for the designation and development of additional EPZs throughout the entire country, or in specific geographic regions. Moreover, a favorable experience with EPZs often creates pressure for economic liberalization and reform of the entire economy, thereby diffusing these policy benefits to a wide range of communities. In this manner, EPZs can be effectively utilized to integrate local producers and products into the world market.

2.115 EPZs 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 export processing zone initiatives during the 1960s, 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 encouraging competitive enterprises to establish themselves within zone boundaries. As their exporting firms became successful, these Far Eastern countries gained confidence in the extension of liberalizing reforms throughout the economy. A similar process has occurred during the past 20 years in Mauritius, where EPZ incentives were the forerunners of general tax, tariff, and regulatory policy liberalization.

2.116 Socialist countries are among the leading users of EPZs as proving grounds for policy reform. At the beginning of its modernization campaign in 1978, the Government of the People's Republic of China designated four "Special Economic Zones" (SEZs) offering liberalized business conditions for investors, including reduced corporate tax rates (even lower than Hong Kong's), Customs duty rebates, and simplified conversion of local currencies to foreign exchange. The Soviet Union, Poland and Hungary are all currently examining the possibilities of EPZ development.

2.117 EPZs have also provided the opportunity for experimentation with the private provision of infrastructure and other services otherwise retained as public sector monopolies. The recently enacted EPZ legislation in Uruguay specifically encourages the establishment of private utilities. In Jamaica, a private international telecommunications station was authorized for service to information processing firms in the Montego Bay EPZ. In these cases and elsewhere, EPZs were used as models to allow private sector initiatives where overburdened public sector monopolies have been unable to provide needed services at prices and standards of reliability required to service the types of export industries and services of the EPZs.

2.118 Countries undertaking structural adjustment and liberalization programs can use EPZs to reinforce broader liberalization measures. In a direct sense, EPZs programs, if properly implemented, can have immediate economic benefits in support of other measures. These are the most demonstrative in terms of employment and foreign exchange earnings. The employment creation and foreign exchange earnings in several countries has been dramatic: from 20,000 to 120,000 jobs in the Dominican Republic in 1982-89, with the acceleration keyed to the adoption of a (largely) market-determined exchange rate under the aegis of a World Bank and International Monetary Fund sponsored structural adjustment program.

2.119 EPZs are no substitute for nationwide policy liberalization initiatives. For a country to introduce maximum economic development stimulus, the broadest possible geographic reach should be given to market-oriented policies. Few backward linkages are likely to emerge from EPZ-based firms -- which must use affordable and high quality inputs to remain competitive in the world market -- unless and until steps are taken to remove constraints upon suppliers in the surrounding economy. Nevertheless, EPZs can play an important role in the larger process of modernization, by illustrating tangible economic benefits that accrue from consistent moves in a market-oriented policy direction.

2.120 In summary, for countries just beginning to establish export manufacturing operations, EPZs can be an important policy tool in facilitating the attraction of industries that would not otherwise locate there. As they become established, successful EPZ programs can serve as means of attracting new and more sophisticated industries and services. Over time, the importance of EPZs can be expected to diminish, as the policies once adopted as a special incentive to counteract the other disincentives in the economy are more widely implanted. In this sense, the importance of EPZs is to a great degree as a stage in the integration of a country into the world economy and the development of a broader industrial base and dynamic modern sector.

III. ASSESSMENT OF THE KENYAN ENVIRONMENT FOR EPZ DEVELOPMENT

A. ELEMENTS AFFECTING THE COMPETITIVENESS OF A POTENTIAL EPZ LOCATION

3.01 In order to assess a nation's competitiveness as a prospective EPZ 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.

3.02 Successful EPZ development is a globally competitive business. Prospective investors compare alternative zone programs in order to select the most attractive business ventures. Local investors perform a similar type of analysis, comparing EPZ investments to other possible investments either locally or abroad. It should be noted, however, that notwithstanding the increasingly sophisticated and highly competitive nature of the global EPZ environment, the availability, cost, and quality of the basic factors of production remain of primary importance in the selection of an industrial site. Also critical is the government's record of providing support to the local and foreign business community. EPZ projects, no matter how well-designed or attractively packaged, cannot compensate for basic economic deficiencies or for investor perceptions of government instability of or bureaucratic complexity.

3.03 The purpose of this chapter is to analyze the Kenyan environment for EPZ development in terms of its locational, economic, institutional, and other attributes.

B. ASSESSMENT OF THE CURRENT MACROECONOMIC CLIMATE

3.04 The GOK has undertaken a number of important reforms in the 1980s which have done much to improve Kenya's macroeconomic climate. Nonetheless, substantial structural weaknesses remain and further liberalization and sectoral reforms are necessary if significant economic gains are to be obtained.

3.05 While exports of non-traditional exports such as horticultural products have increased in recent years, Kenya remains highly reliant on traditional agricultural exports, primarily coffee and tea, as a source of foreign exchange. World prices for both these commodities have slumped, and the collapse of the International Coffee Agreement augurs badly for future improvements in coffee prices. Overall, the terms of trade for Kenyan exports declined by 5.4 percent per year in the 1984-88 period.

3.06 Kenyan GDP growth has been favorable in the late 1980s, registering real growth rates of 5.1 percent per year in the 1984-88 period; however, Kenya's high rate of population growth reduced the per capita GDP growth rate to an unimpressive 1.4 percent per annum over the same period. In addition, job creation continues to lag substantially behind the rate of growth of the labor

force; in 1988, for example, 86,400 new jobs were created while there were some 300,000 new entrants into the labor force.

3.07 A number of important macroeconomic indicators have also registered significant setbacks. The budget deficit in the current financial year is estimated at 4.6 percent of GDP, up from 3.9 percent in the 1988-89 financial year. Despite adoption of a number of measures to encourage exports, including several devaluations and the introduction of a floating exchange rate, the balance of trade has been consistently negative over the 1983-88 period, and the trade deficit has more than doubled since 1986, exceeding US$1 billion. Inflation has risen steadily, from 5.7 percent in 1986 to 10.7 percent in 1988. In reflection of these discouraging trends, net private sector investment has turned negative, and total disinvestment grew from Ksh 3.8 billion in 1986, to an estimated Ksh 5.8 billion in 1989.

3.08 The true extent of Kenya's recent macroeconomic problems is masked to some extent by the fact that foreign donors have provided substantial amounts of aid and loans; in 1989 these funds were equivalent to about 12 percent of Kenya's GDP. This level of aid is not sustainable indefinitely, and moreover, cannot substantially offset the most important structural weaknesses of the Kenyan economy: an over-reliance on the exports of tea and coffee for foreign exchange receipts, and a high rate of population growth. The combination of these two factors has led the GOK and foreign donors to search for alternative policies which offer both significantly enhanced employment opportunities for a rapidly growing labor force, as well as new sources of foreign exchange earnings. This new focus has led the GOK to introduce more export-oriented policies, such as the Manufacturing-Under-Bond program, and to consider the establishment of an Export Processing Zone regime.

3.09 On a more subjective level, Kenya's international image is generally positive, based on the country's history of political stability, generally attractive living conditions, and the presence of a comparatively successful industrial base.

3.10 Kenya's manufacturing sector is among the largest and best developed in sub-Saharan Africa. It consists of about 600 medium and large-scale, 750 small-scale, and 1,700 micro-enterprises, employing a total of 177,000 workers. Since independence, the manufacturing sector has achieved rates of growth 50 percent higher than those of the economy as a whole. The manufacturing sector's share of GDP increased from nine percent in 1964 to 13 percent in 1988.

3.11 The bulk of manufacturing activity is oriented toward import substitution, and has developed under an umbrella of import restrictions and protective tariffs. The structure of manufacturing is heavily oriented toward production of consumer goods (food products, beverages, and textiles). While Kenya's manufacturing sector has, to date, been largely inward-looking due in part to an anti-export bias in government policy and in part to the attractive rates of return available in the domestic market, the existence of a well-developed manufacturing base has a number of positive implications for EPZ development.

3.12 With 45 textile and over 400 garment factories already in operation to serve the local market, firms wishing to establish EPZ garment operations can

draw upon a pool of trained and experienced labor. The manufacturing infrastructure required to support apparel operations (e.g. maintenance and repair services) is also readily available. In addition, the well-developed state of the local textile, plastics, and metal/mechanical industries offer the potential for local sourcing of EPZ inputs, provided that proper incentives are made available to make these goods competitive with imported inputs.

3.13 Based on a review of GOK laws and procedures, and supplemented by interviews with public and private sector representatives, the TSG team has developed several conclusions regarding Kenya's poor export performance in manufactured goods. At a broad-based level, the slow growth of manufactured exports is a reflection of a strong anti-export bias in GOK trade and industrial policy, accompanied by an institutional and administrative apparatus still geared toward import substitution. A second factor is the unwillingness of many local manufacturers to move aggressively to compete in international markets. Most importantly, however, the team has identified a number of inadequacies in current export incentives as a key reason behind the low level of manufactured exports.

C. ASSESSMENT OF BASIC FACTORS OF PRODUCTION

1. Labor

a. Labor Availability

3.14 The size, skills and wage levels of the labor force are a key consideration for firms selecting an EPZ investment site. Free zone industries generally are labor-intensive operations. Typical firms employ 100 to 300 workers, often on two or more shifts. Since a successful EPZ may hold from five to 50 such firms, an adequate pool of affordable, trainable, and productive labor is perhaps the most important economic requisite for success.

3.15 The cost and availability of labor is one of Kenya's key comparative advantages for EPZ development. With a total population of over 22 million, and one of the highest population growth rates in the world, Kenya has a ready supply of unskilled and semi-skilled labor.

3.16 EPZs throughout the world employ mostly female workers, typically between the ages of 18 and 25; in both Mauritius and the Dominican Republic, for example, two thirds of the EPZ workforce is female. Owing to the nature of typical EPZ work, which often requires close attention to detail and good manual dexterity, EPZ employers usually prefer women employees. Overall, Kenya has an ample supply of labor in this category, with more than one million female workers between the ages of 20 to 25. Such increased employment opportunities for women -- and thus, rising income levels -- are consistent with the GOK objective of expanding women's participation in the formal sector, as stated in the government's Development Plan, 1989-1993.

3.17 A corollary to the increased employment of women is the reduction in fertility and birth rates. In Mauritius, crude birth rates fell by 24 percent in the 1975-85 period, and the overall population growth rate dropped from three percent in the 1950s to one percent in the 1980s -- a phenomenon attributed in

large part to rising female employment levels in the EPZs. Again, this secondary impact of EPZ development is in keeping with the GOK's long-term objective of matching population growth to available resources.

3.18 While EPZ work is normally semi-skilled in nature, EPZ workers typically have a secondary school education. Although Kenya has an ample supply of unskilled labor, the pool of skilled labor is more limited; adult literacy levels were estimated at only 47 percent in 1980. In addition, while the number of students in primary schools is quite high, a far lesser proportion of students complete secondary school. Based on a rough estimate, the number of Kenyans aged 25 to 29 who have completed secondary school or above (Form 1-5 or higher) totals 376,000.[1] Clearly, when combined with the available labor pool of workers with a secondary school education aged 18 to 25, the total number of semi-skilled workers is much higher. It is probable that many of these graduates are concentrated in the Nairobi and Mombasa areas, indicating that for the EPZ sites under consideration, an adequate pool of suitable labor probably exists.

3.19 Current secondary school enrollment -- which indicates the upcoming labor pool in the typical 18 to 25 age group -- totals 540,000. The proportion of all secondary school-aged children actually enrolled in secondary school compares unfavorably to successful EPZ host countries: an estimated 20 percent in Kenya, compared to 42 to 51 percent in countries like the Dominican Republic, Costa Rica, and Mauritius, ranging to a high of 71 percent in Singapore. In reflection of the historically unequal educational opportunities for Kenyan women, only 41 percent of those students now enrolled in secondary school are female, totalling 222,000 in the entire country.

3.20 Rough estimates show 14,000 girls now enrolled in secondary school in the Nairobi Province, and some 11,000 in the Coast Province; approximately 26,000 boys are enrolled in the Nairobi Province, and some 20,000 in the Coast Province.[2] As this segment of the population only represents one third of the probable EPZ labor pool, and since it is highly probable that a free zone would attract labor from neighboring provinces, these statistics reinforce the conclusion that an adequate labor supply exists.

b. Wages and Terms

3.21 Minimum wages are prescribed by law and vary according to the type of job, employee age, and location of the operation. Minimum wage rates are divided into three categories: (i) for employment in Nairobi and Mombasa; (ii) all other cities; and (iii) rural areas. There are eleven categories of workers ranging from general laborers to cashier. Average minimum wages for unskilled and semi-skilled workers in the Nairobi area range from Ksh 800 to 1,200 per month. With

---

[1] Based on the number of 15 to 19 year-olds with a secondary school education as measured in the 1979 census.

[2] Estimates derived from 1988 enrollments in maintained secondary schools, which include approximately half of all enrolled secondary school students.

an average work week of 45 hours and fringe benefits which amount to an estimated 30 percent of the basic wage, this translates to a minimum wage of U.S.$0.27-0.40 per hour, highly competitive with labor costs in other EPZ locations.

3.22 Table 3-1 compares Kenya's basic wage rates, excluding fringe benefits, with the wage levels in six EPZ countries. Overall, Kenyan wage levels compare quite favorably to most EPZ locations across most categories; in particular, they compare quite favorably with those of Cameroon, which is also currently in the process of establishing an EPZ. Kenyan wage levels are less competitive, however, for the administrative and professional staff levels. Kenyan administrative costs exceed those found in the Dominican Republic and Mexico, while Kenyan professional wage costs are higher than those found in the Dominican Republic.

3.23 Although the available data cited here suggest that Kenyan wage levels are higher than those of Mauritius for skilled workers, administrative staff, and technicians, the TSG study team believes that these figures substantially understate for a number of reasons current Mauritian wage levels. For one, the latest data available on Mauritian wage levels are for 1987, as compared to 1983 for the other countries cited in the table.

3.24 Two, the current unemployment rate in Mauritius is 2.29 percent, and it is widely acknowledged that the resultant rising wage costs have been the key factor driving the rate of inflation in 1988/89 up to an estimated 16 percent. Indeed, increasingly uncompetitive wage levels have led to the closing of 46 EPZ firms in Mauritius in the first three months of 1989. In addition, a truly comparative analysis would measure relative burdened wages; that is, base wages plus fringe benefits. Although exact data are not available to perform such an analysis, fringe benefits add only an estimated 30 percent to the Kenyan basic wage, versus 40 percent in Mauritius.

3.25 Overtime is paid at one and a half times the normal hourly rate, and two times the normal rate on holidays. It is mandatory that employers pay both social security and health insurance. Leave varies from 21 days (the mandatory minimum) to 30 days per year. In addition, there are 11 public holidays and 30 days of sick leave with full pay. In lieu of annual leave, female employees are entitled to two months of maternity leave. Terminated employees who have worked at least two consecutive months are entitled to one and three-quarter days of leave with pay for each month of service, while employees who are made redundant are entitled to severance pay at the rate of 10 days pay for each year of completed service.

3.26 The minimum legal age for employment is 16. A 45-hour, six-day work week is standard, with 52 hours being the legal maximum for day workers and 60 hours/week for night employees. Limits are also placed on the total amount of regular hours plus overtime that an employee may work in any two-week period: 144 hours for employees working at night, and 116 hours for all other employees.

TABLE 3-1
COMPARATIVE AVERAGE MONTHLY BASE WAGES IN KENYA
AND SELECTED EPZS, 1988
(US$/Month)

	Unskilled Worker	Skilled Worker	Technicians	Admin. Staff	Professional Staff
Kenya	**39**	**104**	**218**	**279**	**500**
Cameroon	119	447	n/a	n/a	874
Mauritius(/1)	45	55	123	113	684
Jamaica	87	221	750	450	1,058
Dominican Republic	74	125	584	100	334
Mexico	129	250	434	275	542
Taiwan	271	327	805	Not Available	3,100

/1 Data for 1987
Source: Data compiled by The Services Group.

3.27 No women or juveniles (between the ages of 16 and 18) may be employed between the hours of 6:30 p.m. and 6:30 a.m. in any industrial enterprise; an exception is made for women engaged in managerial or technical positions. The Minister of Labor may, upon consultation with the Labor Advisory Board, authorize employers to employ women or juveniles up to the hour of midnight, or after the hour of 5:00 a.m.

3.28 Labor regulations stipulate that all employers contribute to national vocational training programs through payment of an industry training levy. On average, the training levy is Ksh 200 (US$9.70) per employee per year. Employers which offer in-house training are eligible to receive a refund. In addition to Kenya's 30 technical training schools, there are four public universities, and three polytechnic institutes. The education system provides eight years of primary and four years of secondary schooling.

3.29 Most manufacturing firms report that Kenyan workers are easily trained and that, owing to the lack of formal sector employment opportunities, levels of employee turnover and absenteeism are relatively low. Many firms have indicated, however, that the productivity of the labor force is also low, thereby increasing operational costs. Nonetheless, existing data indicate that labor productivity in the manufacturing sector has improved over the 1986-88 period. Productivity, crudely measured by the percentage changes in manufacturing output and total numbers of employees, increased by 2.1 percent, 3.4 percent, and 5.7 percent, respectively, between 1986 and 1988.

3.30 In general, the abundance and relatively low cost of Kenyan labor represents a considerable comparative advantage for EPZ development. As in most developing countries, labor shortages exist in some skilled areas, particularly for mid-level managers and skilled machinists. In general, however, EPZ companies have a demonstrated willingness to fill this gap through local training or through the employment of expatriate management.

2. Infrastructure and Basic Services

a. Electricity and Water

3.31 Table 3-2 shows Kenya's favorable standing relative to competitors in terms of its basic infrastrcuture. Electricity is supplied by the Kenya Power and Lighting Company, Ltd. and its associated companies. Total capacity is about 575 megawatts, of which over 60 percent is generated from hydroelectric sources, 32 percent from thermal, and eight percent from geothermal. Further investment in hydroelectric and geothermal capacity is underway and the country is expected to have excess energy capacity by 1990. Power outages do occur, but compared to other EPZ locations, e.g., the Dominican Republic, the power supply is highly reliable. Kenya does not allow the private provision of basic infrastructure such as utilities, although a growing trend among EPZ countries where power outages are frequent is to allow the private provision of electricity.

3.32 Commercial electricity hook-ups are made at the developer's cost and power distribution within private industrial sites must be approved by Kenya Power. Electricity charges for industrial use are highly competitive with other EPZ

locations, averaging an estimated Ksh 0.70 (US$0.03) per Kwh; comparative electricity costs in other EPZ sites range from US$0.05 to $0.10. By necessity, investors must supply their own transformers, however, owing to delays of up to two years that are incurred when transformers are supplied by Kenya Power.

3.33 Water for industrial use is supplied by local authorities. Most urban centers have an adequate water supply along with sewerage and drainage systems suitable for basic industrial purposes. Developers must provide for sewage disposal, and septic tanks are required for individual buildings; in addition, supplemental oxidation ponds are preferred for the industrial site as a whole. Firms engaged in operations requiring large amounts of water or special waste treatment are generally required to provide their own facilities. The Nairobi City Commission monthly water charges in early 1988 averaged Ksh 5.50 (US$0.27) per cubic metre in early 1988. Sewerage fees in Nairobi are Ksh 2.65 (US$0.13) per cubic metre.

b. Telecommunications

3.34 Kenyan telecommunications services are relatively good, but somewhat more expensive than those prevailing in competing EPZ locations. The GPK's Kenya Post and Telecommunications Corporation (KPTC) offers international direct dialing and subscriber trunk dialing services to major cities worldwide. Costs range from Ksh 34.80 to 58.0 (US$1.69-$2.82) per minute for calls to the United States and Europe and Ksh 46.80 to 78.0 (US$2.27-$3.79) per minute for calls to the Far East. A communication tax of 15 percent is also levied. In 1987, there were 145,000 telephone exchanges in Kenya. KPTC also offers telex, facsimile, and data communications service through its Longonot Communications Satellite earth station. Telex charges range from Ksh 30 to 43 (US$1.47-$2.09) per minute to the United States and Great Britain. The number of telex subscribers totalled 2,400 in 1987.

c. Transport

3.35 Kenya's transportation infrastructure is good by regional standards, but air and ocean shipping costs to European and North American markets are relatively high, particularly in comparison with Far Eastern EPZ locations. There are two international airports: one at Mombasa and one at Nairobi; 25 airlines provide scheduled service to and from Nairobi's Jomo Kenyatta International Airport, with direct service available to major markets in Africa, Europe, and Asia.

3.36 The Indian Ocean port of Mombasa is one of the busiest in Africa. The port has 16 deepwater berths, two bulk oil jetties, and several dry bulk wharves. In addition, the port has specialized facilities such as cold storage and warehousing. Mombasa is linked to most of the world's major ports, with over 20 sailings per week to Europe, North and South America, Asia, and the Middle East. Total freight haulage through Mombasa was an estimated 6.65 million tonnes in 1988.

3.37 Mombasa's port charges are, however, among the highest in the region. The tariff on a container destined for transshipment, for example, is 39 percent higher than in neighboring Dar-es-Salaam. Manufacturers also experience considerable delays in movement and clearing of goods. Maintenance levels are poor, and equipment is frequently out of service. At the time of the TSG team's visit, only four of 11 cranes that handle large cargo were operational, while another 50 light cargo cranes that had been unrepaired for over two years. An additional 33 cranes are due to be written off, a decision that has been pending since 1979. The incidence of damage and pilferage of goods is relatively high.

3.38 In addition, the inefficiency of cargo handling operations appears to be rising; for example, the tonnes of dry cargo handled per ship working hour fell by 11 percent between 1984 and 1987. Similarly, the number of ship days in port, which measures ship turnaround time, rose by 26 percent in the 1984-87 period.

3.39 Cargo bound for Uganda and Rwanda is delayed on average for up to three months owing to a shortage of both handling equipment and railway wagons. Ugandan importers and exporters are planning to increase usage of the port of Dar-es-Salaam; Mombasa is losing an estimated 20 percent of its current shipping business to this Tanzanian port because its cargo handling is much faster.

3.40 There is also a 2,100-mile single track railway system, operated by Kenya Railways, which connects Nairobi and Mombasa, and stretches to Uganda. Freight costs from Mombasa to Nairobi average about Ksh 190 (US$9.22) per tonne. Charges for transportation of a full 40 ft. container from Nairobi to Mombasa are about Ksh 7400 (US$359.22), with special contract rates available for frequent users.

3.41 Kenya Ports Authority operates an inland container depot (ICD), located near Jomo Kenyatta International Airport in Nairobi. A special container train service, which commenced operation in 1984, operates between the Kipevu Container Terminal in Mombasa and the Embakasi Container Terminal in Nairobi. Containers offloaded at Mombasa can be directly transferred by rail to the ICD for Customs clearance and exports can be cleared at the depot prior to transfer to Mombasa.

3.42 Within a fenced area covering 30 hectares (74 acres), the depot at Embakasi offers container unloading and Customs clearance facilities as well as warehousing and a container storage yard. A 9,000 sq.m. (96,875 sq.ft.) shed is divided into areas serving import and export cargo. Offices are provided for shipping agents and clearing and forwarding agents, as well as for staff from Customs, Kenya Railways, and Kenya Ports Authority. Government offices, such as the Central Bank or the Ministry of Commerce and Industry, are located within a short distance. Telephone, water, and electricity services are provided. Equipment available at the depot include two rail mounted gantry cranes and six rubber-tired gantry cranes with a capacity of 35 tonnes each.

3.43 It was reported to the TSG team that institutional weaknesses and poor coordination between the Kenya Ports Authority and Kenya Railways is currently impeding the efficiency of the operations of the Inland Container Deport at Embakasi. The shortage of railway wagons and the delays experienced in dispatching available wagons to Mombasa have led to an accumulation of containers at the port. Delays of up to three months have been experienced by container cargo importers.

TABLE 3-2
COMPARATIVE INFRASTRUCTURE COSTS
(US$)

	Electricity (per kwh)	Telephone (per minute)	Water (per M3)	Ocean Transport Cost of 20-ft Container to Major Market
Kenya	**$0.03**	**$1.69-$2.82 to US and Europe**	**$0.27**	**$2,000-$2,500 to Europe**
Togo	$0.11	$2.68-$4.69 to US and Europe	$0.67	$1,130 to Europe
Mauritius	$0.10	$1.60-$1.80 to Europe	$0.56	$2,506 to Europe
Costa Rica	$0.05	$1.68 to US	$1.18	$1,100 to US
Taiwan	$0.11	$5.52-$6.92 to US and Europe	$0.35	$1,100-$1,600 to US

Source: Data compiled by The Services Group.

d. Roads

3.44 Kenya has an extensive road network linked to the networks of most neighboring countries. There are an estimated 54,700 kilometers (33,569 miles) of road, approximately 12 percent of which is paved. Trunk roads cover 6,400 (3977 miles) kilometers, of which some 58 percent is paved. About half of internal freight traffic is carried by road. Surface freight costs from Nairobi to Mombasa average about Ksh 4000 (US$194.17) per 12-tonne vehicle.

3. Capital

a. Capital Requirements of EPZ Firms

3.45 The financing requirements of export firms vary greatly according to the nature of the industrial operation. Heavy industrial operations will have large, recurrent demands for financing to manage inventory and to cover working capital needs. Most light manufacturing operations (especially those working on a consignment basis), on the other hand, have less onerous funding needs because capital equipment requirements are more modest, inputs are not "purchased" but shipped on consignment, and all output is "sold" to the onshore company.

3.46 Nonetheless, the financing requirements of exporting firms can be significant. Adequate funding is necessary at all stages of the investment and exporting process in order to conduct pre-feasibility studies, market research, and trial production runs prior to shipment; to purchase machinery and other assets required for operations; to finance imports of goods used in the production process; and to support export financing and insurance for shipments of goods which are not paid for by letter of credit. In addition, exporting firms often have greater short-term financing needs than do other types of firms because the greater transport times can delay the receipt of payments. Moreover, the financing needs of exporting firms are further complicated by the need to finance imports whose delivery may be slowed owing to transport delays.

3.47 The local availability of financing for industrial development and export manufacturing can be an important attraction for a country's EPZ program. While sophisticated multinational corporations will often arrange financing for overseas subsidiaries utilizing resources available in home country or offshore financial markets, this is usually not an option for local firms or for many smaller foreign firms. Even for subsidiaries of large firms, the availability of local financing is a factor in investment decisions. The lack of medium- and long-term financing poses a major impediment to development because without adequate sources of such finance, substantial fixed investment cannot take place, or if it does take place, such investment is often under-capitalized and is therefore unable to withstand periods of economic adversity.

b. Kenya's Financial Sector

3.48 Kenya has a relatively well developed banking sector. There are 24 commercial banks, 54 near-bank financial institutions (NBFIs), 39 insurance companies, 22 building societies, and four development finance institutions.

Three large, multiple-branch banks dominate the Kenyan banking system. They are Barclays, Standard and Chartered, and Kenya Commercial; these banks account for some 60 percent of all deposits. Interest rates are market determined, and currently stand at 15 percent; non-banking institutions charge 19 percent. Interest rates on loans and overdrafts with a term of less than three years are 15.5 percent, while loan facilities with a term of more than three years carry an interest rate of 18 percent.

3.49 Following a financial sector crisis in 1986 that led to the collapse of two banks and the near-collapse of four others, the GOK introduced a number of measures to strengthen the banking sector. These measures have required improved capitalization and increased liquidity ratios for most of the banking and financial institutions. Although adherence to these requirements is critical to the future health of the sector, the total level of funds available for lending has been reduced as a result, and growth of the financial sector has slowed.

3.50 In recent years heavy government borrowing has reduced the amount of money available for lending to the private sector. In 1985, the private sector's share of domestic credit was 65 percent. This fell to 56 and 54 percent, respectively, in 1986 and 1987. In 1989, however, this trend was reversed as there was a significant decline in net credit to the Central Government and other public sector bodies, while lending to the private sector increased by 20 percent. In addition, the government raised the maximum lending rates and time deposit rates for the commercial banks. This is a positive development, as it was intended to make the financial community more market responsive and to encourage the commercial banks to lend for longer terms.

3.51 To date, commercial lending practices in Kenya have been very restrictive. Commercial banks in Kenya have not generally extended loans for more than three years and have also required such loans to be backed by significant amounts of collateral; the marketable value of the collateral had to exceed the value of the loan by a large margin (as much as 150 percent).[1] While land deeds were once accepted as collateral, the banks have become increasingly reluctant to accept such deeds owing to the lengthy period of time often required to take possession of the property. Medium-term loans are usually for a period not exceeding four years. Longer term loans, from 5 to 8 years, must be obtained from the development banks or from banks such as Equator Bank which have low cost "seed money" from agencies such as the World Bank.

3.52 As a result of these restrictive practices, the majority of loans have gone to large domestic borrowers, while new, unknown firms, and small and medium firms with little equity have been forced out of the commercial loan market. In addition, significant amounts of collateral are required before banks will issue back-to-back letters of credit, thereby reducing the working capital of firms dependent on imports of spare parts and materials.

---

[1] This pattern developed because loan rate ceilings prevented default or risk premiums from being reflected in rate schedules; as noted above, however, maximum lending rates have been recently been raised.

3.53 Local borrowing by non-resident-owned or non-resident-controlled companies requires exchange control approval and is restricted. The definition of "non-resident-controlled" companies is not clear, and reportedly has been interpreted at times to include companies with a non-resident share of only 15 percent. GOK policy discourages foreign investment that relies heavily on local borrowing and non-Kenyan firms can borrow no more than 20 percent of their initial equity capital in Kenyan shillings.

3.54 Until recently, this practice was a deterrent to foreign investment because it exposed foreign firms to a high foreign exchange risk, since their earnings are in shillings while most of their borrowing costs are linked to foreign currencies. In addition, this practice potentially contributed to the under-capitalization of businesses, thereby undermining firms' financial strength. Kenya's donors have urged that these limits on borrowing be eased, and the World Bank in particular has urged that foreign firms be allowed to borrow locally up to at least 50 percent of their capital. While the borrowing limit is a weakness of the Kenyan financial sector, its impact on the EPZ sector would be mitigated if zone firms were allowed to retain their foreign exchange earnings.

3.55 Under the Finance Act of 1989, the GOK now permits companies to deduct from their taxes foreign exchange losses realized on repayment of foreign currency loans. In general, this reduces to some extent the adverse impact of the limits on local borrowing. (Under a typical EPZ regime, however, exporting firms would pay no income tax; thus for EPZ companies, tax deductibility for foreign exchange losses does not offset the fact that foreign companies are limited as to the capital that they can borrow locally).

3.56 Since 1980, banks have been required to direct a minimum of 15 percent of their loans to the agricultural sector.[4] The net effect of such a rule is a distortion of the allocation of credit between agricultural and industrial sectors. Reportedly, enforcement of this rule has been relatively lax in recent years, as banks have been allowed to make fairly generous interpretations of the definition of an agricultural borrower. Owing to the importance of access to domestic sources of credit for potential free zone entrants, however, such a mandated bias in favor of the agricultural sector potentially conflicts with the intent to provide an environment fully supportive of exporters of manufactured products. On average in the 1984-88 period, commercial bank lending to the manufacturing sector has accounted for 25 percent of all commercial bank lending to private enterprises.

3.57 In addition to commercial banks, Kenya has several other sources of equity and loan capital. While some of these sources could be utilized to finance EPZ investments by small- or medium-sized local firms, they are not available or appropriate for financing investments by foreign companies.

3.58 Owing to the virtual lack of commercial bank lending to small and medium-sized firms, the four development banks play an important role in channelling long-term funds to Kenyan industry. There are four development banks directly concerned with industrial finance: the Industrial and Commercial Development

---

[4] The minimum level for NBFIs is only 10 percent.

Corporation (ICDC), the Development Finance Company of Kenya Ltd. (DFCK), the Industrial Development Bank Ltd. (IDB), and the financing operations of Kenya Industrial Estates Ltd. (KIE). In addition, two other development banks -- the Kenya Tourist Corporation (KTDC) and the East African Development Bank (EADB) make loans, sometimes indirectly, to industrial firms.

3.59 In 1988, the four main development banks approved loans totalling K£13.6 million (US$13.2 million), down from K£27.5 million (US$26.7 million) in 1987. The IDB provides foreign currency loans to investment projects in manufacturing, agriculture, and tourism, and does not normally extend loans of less than Ksh 400,000 (US$19,417), for projects with total costs in excess of Ksh 1.0 million (US$48,544). The ICDC is owned by the GOK and is the chief source of government lending to local and foreign joint ventures. The DFCK is owned jointly by the GOK and overseas development banks, and provides medium-term foreign currency financing for agro-processing, tourism, and industrial projects; the maximum investment per project does not normally exceed Ksh 8.0 million (US$388,350).

3.60 The development banks have historically been important sources of venture capital but their loans are made to Kenyan firms only and thus do not represent a financing source for foreign investors. Development bank loans are also expensive in that their loan capital is generally denominated in foreign currencies and borrowers must bear the foreign exchange risk of a depreciating Kenyan currency. Finally, based on their previous portfolio of investments, these banks have no previous experience with infrastructure lending and thus do not represent a potential source of financing for infrastructure within an EPZ.

3.61 Kenya's stock market, established in 1954, is one of only six stock exchanges on the African continent, but is essentially inactive. It is the GOK's intention that the recently created the Capital Market Development Advisory Council will look into ways to invigorate Kenya's stock market. In the near-term, however, this does not represent a potential source of finance for EPZ firms.

3.62 Finally, Kenya's insurance companies and company pension and provident funds are also major sources of equity and loan capital. The insurance companies, however, face tight restrictions in terms of possible investments and they are prohibited from investing in private companies. Likewise, while pension and provident funds are an important source of long-term development capital, they usually do not provide venture capital.

c. Ability of Kenya's Financial Sector To Support EPZ Development

3.63 As presently constituted, the Kenyan financial sector is inadequate to support the short-term financial needs of potential EPZ firms and thus poses a considerable barrier to successful EPZ development. While for large, well-known domestic firms there appears to be no shortage of available funds, access to lending is extremely limited for all other foreign and domestic companies. The current limitations on local borrowing by foreign-owned firms are highly restrictive, and in combination with limits on foreign exchange retention (to be discussed below), pose a substantial deterrent to outside investors. The

requirement that borrowers provide substantial amounts of non-property collateral against short-term loans further limits firms' access to credit.

3.64 Moreover, export manufacturing firms have substantial needs for short-term financing to finance imports and to cover operating costs while awaiting overseas payments. Under the Finance Act of 1989, foreign companies can now borrow locally to pay the duty on imports. This represents an improvement, but further steps need to be taken. The banks' unwillingness or inability to issue back-to-back letters-of-credit poses a severe constraint to the liquidity of these companies. The lack of any form of export financing is a substantial barrier to EPZ development and this constraint must be addressed by the GOK and its donors if the EPZ program is to be successful.

3.65 In addition, the commercial banks' unwillingness to make loans to Kenyan small- and medium-sized Kenyan firms, if continued, will prevent many Kenyan firms from participating, directly or indirectly, in an EPZ. These firms do have access to financing from the four development banks, although it is conceivable that additional donor funding may be necessary if these banks are to be able to make loans towards EPZ development without denying their traditional clients of funds. Both the loan amounts traditionally available from these banks, as well as their apparent lack of experience with infrastructure financing, suggest that alternative sources of EPZ infrastructure financing must be sought.

3.66 The current constraints on medium- and long-term lending probably do not pose a major constraint to potential foreign EPZ investors. In developing countries, medium- and long-term financing are usually more difficult to obtain locally owing to the shallowness of local capital markets. Foreign firms should be able to provide their own investment capital and it may not be unreasonable to restrict most foreign firms from local medium- and long-term borrowing. This policy could, however, discourage the GOK's objective of encouraging joint ventures. It is probable that most joint ventures would have more difficulty borrowing overseas than would 100 percent-owned subsidiaries of a foreign firm; this would be offset to some extent if the foreign subsidiary owned 51 percent of the joint venture. It should be noted, however, that this would then render these firms ineligible to qualify for the tariff relief granted to exports among the 18 members of the Preferential Trade Agreement (PTA).[5]

4. Land

a. Overview

3.67 Kenya's geographical location offers a number of advantages as an EPZ location. The country is well situated to serve markets in Europe and the Middle East, in addition to regional markets in Eastern and Southern Africa.[6] Exports to the United States and Canada, however, are constrained by the country's

---

[5] The PTA is discussed in further detail in Chapter 4.

[6] With the exception of South Africa, to which exports are banned.

distance from North America and the limited availability of direct transportation links.

3.68 While Kenya's varied topography and climate allow for production of a wide variety of cash and food crops, only 20 percent of the land is arable, leaving large areas theoretically available for industrial development, among other uses. Since 1982, there have been some 600 earthquakes in the Rift Valley and Nyanza geological formations, and there have been a growing number of floods in the Kano Plains, the Tana River system, and the Yala/Nzoia river systems. Droughts have been a problem in recent years, particularly in the north and east of the country. There are no reports, however, of any geological or meteorological events that would impede the development or operation of an EPZ in either Nairobi or Mombasa.

b. Land Availability and Cost

3.69 In light of the fact that some 70 percent of the population is still employed in the agriculture sector, the limited amount of arable land -- combined with a rapidly growing population -- has several implications for EPZ development in Kenya. One, any proposed site should be carefully examined to ensure that its use for industrial purposes does not significantly diminish the land available for agricultural purposes. Two, high and growing population densities in urban areas (in 1980, 57 percent of Kenya's population lived in the Nairobi area, versus 40 percent in 1960) have helped to reduce the amount of land available for construction and (in combination with other factors) have driven up land values.

3.70 Land costs are extremely high within both Mombasa and Nairobi. Industrial land in Mombasa costs an estimated Ksh 800,000 per hectare (US$16,835 per acre). Industrial land in Nairobi is approximately one-third cheaper than land in Mombasa, costing an estimated Ksh 500,000 (US$10,521 per acre). This compares favorably with industrial land in well-established EPZs such as Costa Rica ($11,000/acre in the private Zeta free zone), and is highly competitive with land in existing and potential African EPZ sites. Industrial real estate in Mauritius costs from $12,000 to 32,000/acre, while land in Cameroon (Douala Port) costs an estimated $26,000/acre, and that in Togo (Lomé Port), an estimated $36,000/acre. A true comparison of land costs, however, would have to be done on a comparative site-by-site basis, taking into consideration locational attributes such as infrastructure development and land preparation.

3.71 Building costs are comparatively low in Kenya, with an estimated construction cost of Ksh 7 million per 2000 square meters (US$16 per square foot).[1] According to official statistics, building costs have risen steadily over the past three years. The materials costs for non-residential buildings have risen by an average of 11 percent per annum in the 1986-88 period, while labor costs have increased commensurately. In 1988, shortages in the availability of cement led to price increases of 10 percent, thereby raising

---

[1] Figures based on informal quotes received by TSG team in Kenya, and do not include land development costs.

the price of concrete blocks and pipes. There was also a shortage of nails, and increases occurred in the cost of steel, timber, and fuel.

3.72 The total land area of the Nairobi area is 684 square kilometers (68,400 hectares); that of Mombasa is 210 square kilometers (21,000 hectares). Within the Nairobi area, 70 percent of the agricultural land is classified by the GOK as having low agricultural potential, based upon the amount of annual rainfall received.[8] By contrast, all the land within the Mombasa area is classified as high potential agricultural land. Thus, to the extent that this classification remains accurate, a free zone within Mombasa poses a potential tradeoff between agricultural and industrial use, albeit for only a small portion of the total land available.[9] From this perspective, a free zone in Nairobi is slightly preferable because it avoids the use of scarce potentially arable land.

3.73 Within Nairobi, the industrial district is densely developed, highly congested, and in considerable disrepair. Despite the district's close proximity to the airport, the journey of only a few miles between the two areas currently takes about 45 minutes. The congestion in this area militates strongly against EPZ development within Nairobi's industrial district.

3.74 Overall, the absence of readily available land for industrial development offers both a constraint and opportunity for EPZ development. Initially, while it may be difficult for a private EPZ developer to gain access to suitable land, once such land is obtained it may open the door to further investment. Thus, the actual development of an industrial-park type EPZ with land or factory buildings available for lease or purchase may remove a principal bottleneck to investment in manufacturing, and may act as a catalyst to further industrial development.

c. Industrial Estates

3.75 The Kenya Industrial Estates (KIE) was established in 1967 as a subsidiary of the GOK-owned Industrial and Commercial Development Corporation. KIE became autonomous in 1978 and was given the objective of providing working capital and longer term loan finance to small-scale indigenous African firms. The principal source of KIE funds is the GOK annual budget, supplemented by donor funds.

3.76 Under the auspices of KIE, land has been allocated for the development of public industrial estates. The program was established in Nairobi in 1967 and was extended throughout the country in 1980. Currently there are eight industrial parks outside of Nairobi, including one in Mombasa. In addition, KIE established Rural Industrial Promotional Centers in 10 locations, with smaller factory space. In 1988, KIE sold all factories in KIE locations throughout Kenya to African entrepreneurs, giving preference to existing tenants. All factories were sold within six months of the decision.

---

[8] Based on the 1979 census.

[9] Sizes of EPZs range from the smallest at 15 hectares (37 acres) to as large as 100 hectares (247 acres).

3.77 Today, KIE retains managerial authority for the estates, including infrastructure maintenance; the provision of electricity, water, and sewage services; maintenance of an emergency medical clinic; postal services; and a 24-hour security system. Manufacturers on KIE sites receive free technical and management advice on the sourcing of machinery, spare parts, and raw materials, and training courses are provided for management and labor.

3.78 The standard buildings provided by KIE facilities are very small and clearly designed for the encouragement of micro- and small enterprises; as such, however, they are clearly inadequate to serve the needs of EPZ firms. For the smallest firms, KIE provides 46 sq.m. (495 sq.ft.) of under-roof space. Medium-sized industries utilize sheds with 325 to 465 sq.m. (3500 to 5000 sq.ft.), while sheds of 465 to 740 sq.m. (5000 to 8000 sq.ft.) of under-roof space is provided for larger industries. Since 1980, the larger sheds have proven too small for four KIE manufacturers who have since moved their factories to larger industrial plots. Typical industries in the KIE estates include garment manufacture; paper conversion and printing; woodworking, including saw milling and furniture making; metal fabrication; and food processing, particularly flour milling and bakery enterprises.

3.79 The World Bank, African Development Bank, and German Development Bank provide funding to KIE for use as longer term low interest loans in the KIE sites. Borrowers must provide matching funds equal to 33 percent of the total, and the total lending limit is Ksh 5 million (US$242,718). All lending is restricted to Kenyan Africans. For those investors who lack the matching funds, the KIE hopes to develop a venture capital market to assist new firms.

3.80 With the sale of its industrial facilities, the institutional portfolio of KIE has been reoriented towards technical assistance, with a focus on lending to small firms on easy credit terms. Because the KIE's clients are small firms with little collateral, the KIE has had severe problems with arrears and bad debt. As of mid-year 1986, KIE had Ksh 89 million (US$4.3 million) in loans outstanding, of which some 25 percent were in arrears. Reportedly, KIE's financial difficulties have been exacerbated as well because a number of operational decisions have been strongly influenced by political considerations, particularly when the leasing or sale of KIE property has been concerned, and loans have also been awarded to non-viable enterprises on subjective criteria.

3.81 The KIE physical development program is clearly a "business incubator" project aimed at fostering small-scale indigenous entrepreneurial development through the provision of appropriate factory space, services, technical advice, and loans. As such, the KIE program does not offer EPZ-style facilities. The under-roof space offered under the KIE program is clearly designed for the needs of small-scale entrepreneurs; even the largest sheds are far too small for the average small EPZ firm. On average, free zone firms would be expected to utilize

from 1000 to 4000 sq.m. (10,764 to 43,055 sq.ft.) of under-roof space.[10] In addition, the institutional focus of KIE -- with the objective of addressing the needs of small-scale African entrepreneurs -- differs greatly from the perspective of a successful EPZ agency. The insufficient size of the KIE sheds, combined with the lack of any other industrial estates program in Kenya, underscores the need to select and establish a separate EPZ site and program.

3.82 Nonetheless, the industries located in the KIE areas may be a pertinent focus for the fostering of backward supply linkages between EPZ firms and small indigenous firms. Packing materials, furniture, and intermediate inputs for textile firms are all highly appropriate areas where the KIE firms could be linked to EPZ companies.

5. Other Factors Influencing Production

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

3.84 Kenya has a number of these non-quantifiable factors to its credit. Compared to most of its African neighbors, Kenya has enjoyed a high degree of political and social stability, both of which are important to EPZ investors. Likewise, the country has a diversified and dynamic private sector and has a long history of substantial foreign investment. Finally, Kenya is a highly attractive place of residence for expatriates and their families.

3.85 There are a number of factors, however, which potential investors may find disquieting and which may make them cautious about investing in Kenya. Despite repeated GOK statements in support of foreign investment, policies have often belied the formal positions taken. Businesses operating in Kenya have been subject to a myriad of controls that have constrained operational flexibility and reduced profitability, while some sectors of the bureaucracy have been openly ambivalent as to the desirability of foreign investment. Likewise, while the GOK's record with regard to such actions as nationalization is quite positive, the rhetoric associated with the government's desire to promote "Kenyanization"

---

[10] This standard is borne out by export-oriented firms in Kenya as well, where 9 to 14 sq.m. (100 to 150 sq.ft.) under-roof space per worker is the average. Firms with large amounts of space dedicated to warehousing and/or more luxurious standards may require even more space per worker. In Cameroon, for example, a small, 100 percent Cameroonian-owned manufacturer of women's undergarments, employing only 110 persons, utilizes 3,800 sq.m. of under-roof space, while larger Cameroonian firms use anywhere from 10,000 to 45,000 sq.m.

through local equity ownership in foreign firms has proven worrisome to foreign investors.

3.86 Finally, Kenya is a multi-racial, multi-ethnic society, and as such has exhibited not only the advantages but also the difficulties associated with such diversity. Competition for economic and political power among African ethnic groups is further complicated by the existence of a large, highly visible Asian community. Justifiably or not, there is a perception among many potential investors that government support for private investments, as well as the long-term viability of such investments, is often influenced by tribal and/or ethnic factors. In general, any perception of favoritism or uneven treatment inhibits new investments, particularly of foreign origin.

3.87 None of these single subjective factors -- either positive or negative -- will 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 wide variety of fronts if they are to be successful.

D. ASSESSMENT OF THE EXISTING REGULATORY/INSTITUTIONAL FRAMEWORK AND PROCEDURES

1. Overview

3.88 This section assesses the Kenyan regulatory and institutional environment for EPZ development from a comparative perspective in order to assess its international competitiveness. Like the basic factors of production, the existing regulatory/institutional framework is critical to the ultimate success of an EPZ. Many free zones around the world have economically favorable basic factors of production, especially large supplies of low-cost labor, but are uncompetitive sites for investment owing to regulatory or bureaucratic limitations. These weaknesses include such factors as constraints on the use of foreign exchange, burdensome or corrupt customs procedures, restrictions on land ownership, lengthy investment approval processes, and the like.

3.89 Despite an announced shift away from import substitution, Kenya has yet to comprehensively remove impediments to export sector success. Trade policy retains a strong anti-export bias, as manifested in terms of high effective rates of protection, price controls, uneven access to imported production inputs, and burdensome export administrative procedures. As a result, manufacturers generally find it much more profitable to produce for the protected local market.

3.90 A comprehensive 1987 World Bank survey of Kenya's industrial sector calculated that the overall weighted average nominal rate of protection for Kenyan manufactured goods was 34 percent.[11] This study calculated that the average effective rate of protection for the same sample of goods was 89 percent. The difference between the nominal and effective rate of protection reflects the

---

[11] The nominal rate of protection is the domestic price of a given product divided by its border price. World Bank (1987).

fact that, in addition to tariff protection, Kenyan manufacturers are also protected by both quantitative restrictions and by official pricing policies that set prices of raw materials below world prices, thereby subsidizing local industry.

3.91 Those manufacturing firms which do attempt to export are frustrated by difficulties in obtaining import licenses and the foreign exchange needed to import required raw materials and intermediate goods. Equally frustrating is the problem of obtaining adequate foreign exchange to facilitate overseas travel for business-related purposes; as well as the difficulties and high cost of Customs clearance of imports and exports.

3.92 The remaining import substitution bias of the GOK institutional and administrative bodies exacerbates the anti-export bias of the country's overall trade policy orientation. While top GOK officials are aware of the necessary policy changes that successful export promotion requires, and have announced these changes in major policy documents and annual budget speeches, the proclaimed shift in favor of an outward-looking trade orientation does not seem to have filtered down to the implementation level. Once announced, policy shifts toward export promotion either have not been implemented, or have been implemented in a manner that erodes their incentive value. Furthermore, exporters find that they are often viewed with suspicion; they are frequently accused of withholding foreign exchange from the Central Bank and held subject to criminal penalties for foreign currency-related violations.

3.93 This gap between announced policies and actual implementation is equally evident in the GOK's attempts to streamline the investment approval process. Rules and procedures are often not written down, or are presented in such a vague fashion that they allow a discretionary or arbitrary interpretation. This lack of clarity results in an inconsistent and/or cumbersome application, which in turn creates the perception, if not the reality of discriminatory treatment. Furthermore, such a lack of transparency creates a perception of policy instability -- a factor which is often viewed more negatively by investors and exporters than the inadequacies of policies themselves.

3.94 While manufacturers complain of the anti-export bias of GOK trade policy, GOK officials argue that the Kenyan private sector is often unwilling to take the steps required to compete successfully in international markets. They suggest that, despite GOK enactment of a number of export incentive measures, most firms prefer to content themselves with production for the protected local market, strongly complaining of any moves to liberalize competing imports.

3.95 There is no doubt that there is some merit in the GOK view summarized above. Many local manufacturers clearly do not have the ability to compete in world markets, no matter what type of incentives are offered. Outmoded technologies, inefficient production methods, and poor quality control make it impossible for many firms to meet world cost and quality standards. As a result, it is likely that any significant increases in manufactured exports will most likely have to come from new ventures geared primarily toward external markets. Some of these ventures may, however, be set up by established manufacturers, given the initiation of new incentive programs.

3.96 In the final analysis, the regulatory and institutional framework is the single most important factor in the success or failure of a free zone. The ease and efficiency of the investment process and of business operations is a critical element of the financial profitability of EPZ firms. Like the basic factors of production, the regulatory environment is assessed by investors on a comparative basis with other zone programs, and therefore must be highly competitive. Unlike the basic factors of production which cannot be easily changed, however, the regulatory framework is an area in which governments can immediately make improvements without significant expenditures of time or money. More significantly, changes to, or the additional liberalization of, the regulatory framework can be used to offset or compensate for any weaknesses in the basic factors of production, thereby enabling the overall design and implementation of an incentives package which is highly competitive.

2. Assessment of Existing Schemes for Export Processing

3.97 In support of its stated objective of increasing exports, the GOK has enacted over time a number of specific export incentive measures designed primarily to counter the overall anti-export bias of existing trade policies. The three most important incentive measures are the Export Compensation Scheme, the Manufacturing-Under-Bond program, and the Green Channel Scheme.

a. Export Compensation Scheme

3.98 The Export Compensation Scheme (ECS) is the Government's principal export incentive measure. Enacted under the Local Manufactures (Export Compensation) Act of 1974, the scheme provides for a cash payment intended to offset the import duties paid on the inputs utilized in the production of manufactured exports.

3.99 The level of compensation payable under the scheme has varied over time. In 1974, compensation was set at a flat rate of 10 percent of the FOB value of manufactured exports. In 1980, the level of compensation was raised to 20 percent. Two years later, the scheme was abolished, only to be reinstated in 1984 at a rate of 10 percent plus an incremental rate of 15 percent for exports over the previous year's level. In 1985, the flat rate was raised to 15 percent and the incremental rate lowered to 10 percent. Since then, the incremental rate has been eliminated altogether, and the flat rate increased to 20 percent, which is where it now stands.

3.100 Under the ECS, the Customs Department is given responsibility for reconciling exporters' documents with those of the exporters' banks. Customs must ensure that:

- the goods stated on the documentation are eligible under the Export Compensation program;
- the claim for compensation is lodged within the time allowed;
- the amount claimed is correct;
- foreign exchange was received for the exports; and
- all requisite documentation is correct.

3.101 The impact of the ECS as a tool for promotion of manufactured exports has been limited. There is no clear correlation between total EC payments made and the growth of manufactured export earnings. In addition, the number of eligible firms receiving export compensation has been relatively small. The majority of manufacturers interviewed by the project team view the scheme as an ineffective measure for promoting exports. Principal deficiencies include the following, each of which will be discussed in turn:

- inadequate incentive value;
- restrictive requirements;
- cumbersome paperwork; and
- lengthy payment delays.

3.102 **Inadequate Incentive Value**: As noted above, the ECS currently offers a cash payment at a flat rate of 20 percent of the FOB value of manufactured exports. This level of compensation is inadequate as an effective export promotion measure in two respects. First, the 20 percent cash payment is often insufficient to offset the level of duties paid on imported inputs. For some industries, 20 percent compensation represents a "windfall," however for many others, the aggregate level of duty and sales tax paid on imported inputs is well in excess of 20 percent.

3.103 Second, even for those industries where 20 percent compensation offsets import duties, ECS only goes so far as to accord them "neutral status"[12] (i.e., to put them on an even footing with international competitors). It can be argued, however, that in order to induce manufacturers to reorient production to export markets, any scheme must go further. That is, they must be provided with "extended neutral status," (a level of incentive equivalent to the effective rate of protection enjoyed in the domestic market). Otherwise, companies will always find it more profitable to produce for the home market than for export.

3.104 According to the previously cited World Bank study of Kenya's industrial sector, the average rate of protection for "efficient" industries is 43 percent.[13] Thus, the ECS rate would have to be increased significantly to induce these firms to reorient production to export markets.

3.105 **Restrictive Requirements**: There are a number of other elements of the scheme that limit its effectiveness as an export promotion measure. One is the list of items eligible for compensation. The number of items currently eligible is about 800, down from an earlier number of over 2000. Furthermore, the list of eligible items changes frequently and there does not appear to be any clear

---

[12] The concept of "neutral" and "extended neutral" status for exporters was introduced by Y.W. Rhee (1985).

[13] The study measured efficiency in terms of domestic resource costs (DRC). The DRC measures the relative efficiency of the use of capital and labor resources in various industrial activities. The lower the DRC, the more efficient the use of net foreign exchange per unit of production. Activities with a DRC ratio less than or equal to 1 are considered to be "efficient."

criteria for selection of eligibility, thereby reducing the credibility of the scheme. Unless manufacturers can be certain of their eligibility, they will be reluctant to adjust their prices, or any other aspects of their operations, to reflect the anticipated receipt of compensation.

3.106 **Cumbersome Paperwork**: Virtually every manufacturer interviewed by the project team complained of the cumbersome paperwork and procedural requirements associated with the EC scheme. In filing for export compensation, an exporter must deal separately with at least three institutions -- a commercial bank, the Central Bank, and Customs. Within Customs alone, there are at least four levels of checks and audits before payments are issued. A number of manufacturers indicated that frequent "interventions" are required to expedite payments.

3.107 **Lengthy Payment Delays**: According to Customs officials, when all documentation is completed, it should take 10 to 30 days to receive the Export Compensation cash payment (compared to the 6- to 18-month wait that has been widely experienced by exporters under the program). The Customs officials admitted, however, that delays could occur due to improper documentation, the volume of work confronting the Customs officers, or a lack of sufficient GOK funds to pay the compensation. Manufacturers frequently complain of waits for processing of ECS claims. The TSG study team was told by one exporter that his firm has had Ksh 50 million (US$2.4 million) in compensation outstanding for over two years, and the Central Bank acknowledges that some claims from 1987 are still being processed. On the other hand, many manufacturers indicated that processing times have been reduced significantly -- from an average of six months to a current average of 4 to 6 weeks. As with uncertainties regarding eligibility, exporters are unlikely to adjust pricing in anticipation of export compensation unless they can be assured that payments will be processed on a timely basis.

b. Manufacturing-Under-Bond

3.108 The Manufacturing-Under-Bond (MUB) scheme is intended to redress some of the deficiencies of the ECS scheme, most notably the failure to offset the full cost of duties on imported production inputs. Although announced in the Fifth Development Plan and in Sessional Paper No. 1 of 1986, the MUB scheme was not fully implemented until 1988. To date, 19 firms have been licensed under the scheme, although only 3 have actually begun operations; each operational MUB firm was interviewed by the TSG team.

3.109 Only firms which produce entirely for export are eligible for MUB licensing. In addition, the scheme is limited to operations located in Nairobi, Mombasa, or Kisumu. The program is open to both foreign and local investors. To be licensed under the scheme, a firm must show evidence of a market for all of its production, access to adequate technology, and sufficient financial backing. In addition, firms must demonstrate that the total value of exports will exceed Ksh 10 million (US$460,000) or that they will create at least 50 jobs.

3.110 Under the MUB, the responsibility of Customs includes (i) licensing the premises of the manufacturer, which includes ensuring that the premises are built and secured to meet Customs bonded warehouse requirements; (ii) processing of

documents; and, (iii) inspection and supervision of the manufacturing operations of the firms through the provision of a Customs Officer, an Examiner, and a Collector to the MUB site.

3.111 Preference is given to investors willing to enter joint ventures with Kenyan partners. Customs can issue licenses for MUB production only after approval is given by the Minister of Finance and upon recommendation of a committee comprised of representatives from the Ministries of Finance, Commerce, Industry, and Planning and National Development; the Central Bank; the Customs and Excise Department; and the Investment Promotion Centre.

3.112 Firms licensed under the scheme are eligible to import free of duty all machinery, raw materials, intermediate goods, and other inputs required for export production. Licensees are required to provide all office space and equipment required by Customs officials, who must be physically present at the factory during all hours of operation. Licensees also must cover transportation costs for Customs officials.

3.113 Customs expressed no problems in the management of the MUB program, likely due in part to the fact that very few firms are actually functioning as MUB operations. Those Customs Officers who work directly at MUB sites appear well-informed regarding MUB privileges and procedures. Those officials who do not work directly with the MUB firms, however, were not well-acquainted with MUB regulations. Indeed, within the Customs Department there was a general lack of knowledge regarding the specific requirements of MUB manufacturers, as well as export manufacturers in general. This lack of understanding and knowledge is a constraint to the overall effectiveness of the MUB program and impedes the implementation of more streamlined Customs procedures.

3.114 MUB firms interviewed by the TSG team voiced a number of complaints regarding implementation of the scheme. These include the following, each of which will be discussed in turn:

- level of license fees;
- requirement of multiple bonds;
- treatment of offcuts and rejects;
- payment of Customs officials;
- high cost of local goods; and
- Customs procedures.

3.115 **Level of License Fees**: All of the firms interviewed complained of the MUB license fee requirement. The annual license fee is currently Ksh 40,000 (US$1912), and must be renewed on the 1st of January, regardless of the commencement of operations. This is contrary to GOK practice with other licenses levied by the government (e.g., driver licenses), which are granted for a 12-month period. MUB operators expressed the view that coupled with import license fees, bond fees, expatriate work permit fees, and port handling fees, the MUB license fee poses a undue financial burden.

3.116 **Requirement of Multiple Bonds**: MUB firms are required to post up to five separate bonds, depending on the number of ports of entry utilized for

importation of production inputs. On average, each of the firms interviewed reported posted bonds of about Ksh 3.5 million (US$170,000).

3.117 **Treatment of Offcuts and Rejects**: All of the MUB firms interviewed complained vociferously of the current requirement that all offcuts and rejects must be exported or burned under Customs supervision. MUB firms are required to have three separate storage areas -- one for raw materials, one for finished goods, and one for wastage. At each of the factories, the storage area containing wastage was full to capacity. The manufacturers argue that cloth offcuts and rejects are currently imported for use in production of mattresses, towels, and blankets. They would like to be allowed to sell these rejects in the local market. In addition to the waste involved in destroying potentially usable materials, there is a tremendous waste of time and labor as Customs officials must inspect the wastage materials.

3.118 **Payment of Customs Officials**: MUB requirements stipulate that one Customs inspector and two Customs security officials must be present at the factory during all hours of operation. Overtime must be paid by the licensee for any work done outside of normal working hours (8 a.m.-12 p.m.; 2 p.m.-5 p.m.). It was reported that the combined cost of overtime and transportation for Customs officials averages about Ksh 15,000 (US$728) per month.

3.119 **High Cost of Local Goods**: MUB managers reported that they are constrained from using local inputs, other than labor, by the high cost of local materials. All indicated a willingness and desire to use local cloth, thread, and packaging if they can be made available at competitive prices. They reported that the import duty content and sales tax on local goods more than offsets any savings in freight costs.

3.120 **Customs Procedures**: Like other importers and exporters interviewed by the project team, MUB managers complained of cumbersome Customs procedures. Their complaints fall into two categories -- delays and cost. IPC representatives indicate that the intention of the MUB scheme is to allow for direct transfer of imported goods from the port of entry to the bonded factory, and direct transfer of exports from the factory to the port of exit, with clearance and inspection performed, in each case, at the factory.

3.121 In practice, however, MUB managers report that goods are being inspected first at the port of entry (often by as many as four different sets of officials) and then again at the factory. As a result, it may take as long as 2 to 3 weeks for the goods to arrive at the factory. This is unacceptable to firms working under tight delivery schedules, and undermines the intention of the program which is to facilitate exporters.

3.122 Managers also complained of high Customs charges and port handling fees. One particular point of complaint was the fact that Kenya Ports Authority counts Saturday and Sunday as part of the 3-day grace period allowed before which Customs storage charges begin to accrue, despite the fact that KPA and Customs officials are not available on those two days to release and clear goods.

3.123 Customs officials did not appear to be at all aware of Kenya's current plans for an EPZ scheme. A number of them were familiar, however, with the EPZ

concept; and a few of them had visited EPZs in other countries. Were a Kenyan EPZ regime to be established, Customs indicated a willingness to play its role as required by the Treasury. The Customs Department expressed a desire, however, to be involved at an early stage to assist in defining procedures for the EPZ and in discussing their feasibility; for example, Customs officials expressed a preference for a simplified procedural framework. The proximity of the EPZ site to a port of entry, would, according to Customs officials, be a very important factor in the administration of their duties.

c. The Green Channel Scheme

3.124 The Green Channel Scheme was recently introduced in the context of the Development Plan, 1989-1999. The scheme is intended to simplify and accelerate the process by which exporters receive import licenses and allocations of foreign exchange. The program is designed to reduce the lengthy delays involved in obtaining foreign exchange which served to constrain exporters. The scheme primarily consists of the utilization of green forms and folders which are readily distinguishable and which can easily be given priority at various stages of processing. Implementation of the program has involved both the Ministry of Commerce and the Central Bank.

3.125 Private sector firms interviewed by the TSG study team have reported that the Green Channel Scheme has been highly effective in accelerating approvals process and in reducing the delays experienced by exporters. Under the scheme, import licenses are promised to exporters within 48 hours and foreign exchange is to be allocated within a day; in reality, the whole process takes about two weeks, but this is a great improvement over the average three months (and occasionally six months to a year) experienced prior to implementation of the scheme. The Ministry of Commerce has recently announced the opening of a special counter at the Ministry, dealing exclusively with Green Channel importers, which is reserved for businessmen.

3. Customs Policies/Procedures

3.126 The Customs and Excise Department of the Ministry of Treasury is charged with control, valuation, and monitoring of the passage of merchandise across Kenya borders. The investigations conducted by the TSG team with regard to Customs clearance are summarized below. An analysis of the organizational structure and functions of the Customs and Excise Department is presented in Annex C.

3.127 Customs clearance procedures should take a maximum of four days for importation and two days for exportation, according to the Customs officials interviewed. Representatives of Customs insist that a distinction should be made between delays caused by exporters or importers themselves by providing incorrect or inaccurate information and those which are legitimately charged to the Customs bureaucracy. As could be expected, Customs officials argue that the primary responsibility for delays lies with the business community; most delays of two weeks or longer are caused by poor documentation or by the inability of

importers or their agents to raise funds to pay the requisite duty and sales tax on imports.

3.128 Special consideration is not necessarily given to export manufacturing operations by Customs. Although there is a special section of Customs charged with administering the Export Compensation scheme, and more recently, Manufacturing Under Bond, export manufacturers, as a whole, do not receive priority treatment in Customs processing. In fact, Customs officials did not appear to be familiar with the requirements of the export sector in the interviews conducted.

a. Issues and Constraints: The Customs Perspective

3.129 The following areas were cited by Customs officials as obstacles to their effective operation:

- The department requires improved training programs for personnel (overseas education, use of outside technical assistance) and new training equipment.

- The fact that there is no computerization of the data base of the Customs Department leads to delays, procedural errors, missing documentation, etc.

- The valuation of goods is a major problem. Customs officials claim that importers sometimes give "fake" valuations, and that most officers do not have adequate knowledge to verify the actual value of goods. Reportedly, the GOK is appointing specialized firms for this function and for pre-shipment inspection. Computerization would also help to improve the valuation process.

- There is an overall recognition of the need for "the modernization of Customs operations," and for streamlining procedures so as to avoid delays. Centralized authority slows the decisionmaking process; for example, no major decisions can be made at Mombasa without official written communication with the Commissioner in Nairobi. Senior officials also admit there is a need to reduce the time it takes to transfer documents between officers.

- Incidents of corruption within the Customs department have been widely reported. This problem is to some extent ingrained in the system since some members of the import/export community collude in the commission of the offenses.

- Improvements to internal audit systems are necessary in order to improve investigation and detection of customs-related criminal offenses. Periodic unannounced audits are now conducted but punishment of violators is a lengthy process, and therefore lessening the deterrent effect on other violators.

- Improvements to the system of sanctions and rewards for Customs employees are also required. This would help to offset the problem of low salaries, which are felt to be demoralizing and which contribute to corruptive practices. In addition, improved terms of service of Customs officials would increase morale and improve performance; e.g., the introduction of staff welfare schemes

b. Issues and Constraints: The Private Sector Perspective

3.130 Private sector individuals interviewed, including a number of leading clearing and forwarding firms, viewed Customs procedures as unnecessarily cumbersome and overburdened by personnel; almost all said that Customs officials did not appear to understand -- or wish to understand -- the requirements and problems of the private sector. It was also alleged that too many officials demanded to be paid for services that should be provided as a matter of duty. Two areas in particular were mentioned:

3.131 Personnel Constraints. A specific problem that was pointed out by nearly every private sector person interviewed was the large number of Government officials involved in the clearance of goods. For example, it was reported that an inspection of goods at any one time would involve almost a dozen people; as many as five of these would be from the Customs Department itself, with one representative of each of the following:

- entry processing;
- inspectorate staff;
- audit section staff;
- valuation officers; and
- preventive officers.

In addition to these Customs officials, there are often other GOK departments represented, such as, the police; Ministry of Commerce, Trade and Supply Section; and Kenya Ports Authority.

3.132 According to the firms interviewed, each of the public sector officials involved in the clearance of goods normally wanted to work or make an approval alone, not in a team with the others; this not only adds to delays but increases opportunities for corruption. In addition, an importer or clearing agent has to contend with messengers who transfer documents from one officer to another, forklift drivers, fundis, and a host of other supporting staff who all require "an incentive" over and above their normal pay in order to do the work they are normally supposed to do.[14]

---

[14] Indeed, the whole clearance system has become so cumbersome that clearing and forwarding firms have increased rapidly over the years. There are at least 50 large firms and numerous other small ones, not to mention the reported existence of unregistered, "briefcase" clearing agents who work full-time in that "business."

3.133 There are also cases of reported theft especially of detached goods with a ready market -- such as car radios and cassettes, spare parts, drugs and medicines, and tires. Ports Authority officials were said to be often apathetic to these incidents, with the inevitable result that such theft continued to happen even when frequently reported.

3.134 Documentation Requirements. Exporters and clearing and forwarding agents report that they are finding exporting easier than importation. Customs documentation requirements are changed, although not too frequently, in attempts by Customs "to seal observed loopholes." Clearing agents claim they receive no advance notice of these changes, discovering them only when they forward their usual documents -- and are told that there are now other documentation requirements in force. Laxity, reluctance to "adopt a business attitude," and too much paperwork were also mentioned as problems in the Customs procedures.

4. Investment Approval and Business Formation Policies/Procedures

3.135 Investors have frequently complained of the cumbersome procedures associated with the investment application and approval process in Kenya. While approval procedures have been streamlined, to some extent, under the auspices of the Investment Promotion Centre (IPC), multiple approvals and licenses are still required, and the process of applying for and receiving approvals can be difficult and time consuming.

3.136 The number of approvals applicable to a given investment project varies, depending upon the type of operation and nationality of ownership. The IPC has compiled a checklist which identifies 34 separate approvals which may be applicable to new investments. In addition, there are 20 separate GOK agencies involved in issuing the approvals and licenses included in the list.

3.137 Approvals which could be applicable to an EPZ firm include:

- trade, import and export licenses;
- industrial registration;
- license for sale of manufactured goods;
- approval for allocation of government land;
- approval for change of land use;
- approval for building plans;
- approval for factory registration;
- approval to discharge effluent/waste disposal;
- approval for management/service agreements involving nonresidents;
- approval for foreign currency borrowings; and
- permission to employ expatriate workers.

3.138 For foreign-owned businesses the following additional approvals could be required:

- certificate of approved enterprise;
- permit to allot shares to nonresidents; and
- permit to appoint nonresident directors.

3.139 Firms operating under the MUB program must also complete a further 10 or more separate documents to satisfy customs procedures; a number of these forms must also be completed in sextuplicate copies. The forms to be completed and examined include the following:

- Manufacture-Under-Bond Import Entry (Form CF1(r.79A)(1)- Bonded Factory Declaration (Form CF1)
- Application for license of Premises to be used as Bonded Factory (Form CF2(1))
- License for Customs Bonded Factory (Form CF.3(3))
- Manufacture Under Bond Export Entry, Form CF.4 (r.79E)
- Manufacture Under Bond (Port of Entry) Register (Form CF.5 (r.79A)(3))
- Machinery and Raw Materials Register (Imports/Local) (Form CF.6(r.79A)(5))
- Manufactured Goods Register (Form CF.7 (r.79C))
- Waste and Rejects Register (Form CF.8 (r.79D)(1))
- General Bond for the Security of Warehoused Goods or Removal for Manufacture and Export Under Bond (Form CFBI (r.79B(5))

3.140 Despite the fact that the MUB program is intended to facilitate export manufacturing operations, it is clear that not only has the program not streamlined the GOK's complex approval process, but it has in fact added yet another layer of bureaucratic complexity to business operations in Kenya. This is particularly burdensome for export industries because exporters, more than other businesses, must be able to act in an expeditious manner.

3.141 The GOK has established an "Investment Facilitating Committee" at the IPC which is intended to function as a "one-stop-shop." In theory, investors can, with assistance from IPC, complete an investment proposal form which consolidates most of the information needed for required approvals. Once approval has been granted by the Investment Facilitating Committee, all necessary licenses and approvals should to be issued automatically. In practice, however, investors still report delays in obtaining certain approvals, even after their projects are approved. To a large extent, all investment applications are still dealt with on a case-by-case basis, with no clear criteria for evaluation. This procedure gives a strong impression -- whether or not justified -- of uneven treatment.

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

3.142 The GOK imposes strict controls on access to and use of foreign exchange in Kenya. Administration of exchange controls is the responsibility of the Central Bank of Kenya under provisions of the Exchange Control Act (ECA). The ECA is wide-ranging in its application, covering virtually all types of foreign exchange transactions

3.143 The ECA requires all residents (defined to include both individuals and corporations) to surrender to the Central Bank or to an authorized dealer all

foreign currency brought into Kenya. Residents are not permitted to maintain overseas bank accounts without special permission from the Central Bank. Similarly, no resident may borrow foreign currency without approval from the Central Bank. Maintenance of inter-company accounts between resident and non-resident companies or branches is prohibited without approval.

3.144 Foreign exchange allocations to cover imports are provided in conjunction with issue of import licenses. There is a charge on all foreign exchange allocation licenses which is equivalent to 1.5 percent of the cost and freight value of the items to be imported. According to official policy, recipients of import licenses for capital goods, raw materials, and intermediate manufacturing inputs (Schedule 1) should receive automatic exchange allocations. It was reported to the project team that this does not always occur in practice.

3.145 All exporters are subject to export licensing to ensure inward remittance of export proceeds; 100 percent of such proceeds must be received and turned over to the Central Bank within 90 days. There is no provision for retention of foreign exchange to cover imports or business travel.

3.146 Foreign exchange allocations for business-related travel are granted upon recommendation of the Ministry of Commerce. Allocations are dependent on the destination of travel and duration of the visit. Business travellers to Tanzania and Uganda receive up to Ksh 400 (US$19) per night for a maximum of 10 days at one time. A maximum allowance of up to Ksh 1,500 (US$69) per day is available to business travellers to other countries for no more than 20 days.[15] These levels are unchanged from the 1985 allowance levels and exporters report that the allocations provided for certain destinations are insufficient.

3.147 Limits also exist on the repatriation of the salaries of foreign nationals. Foreign nationals who have not been in the country for more than four years can remit abroad up to one third of their monthly salaries, up to a maximum of Ksh 4,000 per month ($US 185). Additional remittances are possible to cover such items as educational expenses, if total remittances do not exceed one half of their monthly salaries. Expatriates who remain in Kenya for more than four years may remit their salaries, as above, but are not allowed to transfer additional savings upon their emigration.

3.148 The Kenyan Constitution provides a basic guarantee against expropriation of private property without full and prompt compensation. Foreign investments approved under the Foreign Investment Protection Act (Cap. 518) are permitted to remit profits, capital, and principal and interest required for the servicing of any loans specified at the time of approval.

3.149 This only covers, however, the original registered value of the investment; it does not include profits which arise from the increased value of

---

[15] Allowances as of December 1988. The inadequacy of these allowances is illustrated by the comparable U.S. A.I.D. per diem rates of $160 for Uganda (Kampala) and $105 for Tanzania (Dar-es-Salaam); for London, New York, and Hong Kong the rates are $161, $141, and $160, respectively.

any capital asset. Capital gains are blocked from immediate repatriation and must be invested in Government securities for five years; it was only recently that the rate of interest made available on these securities was raised to commercial levels. The interest income from these securities is fully repatriable, but the foreign exchange risk remains with the investor until the five years is completed.

3.150 Prior to 1988, approved investments were required to be registered in Kenyan shillings, and only the original shilling value of the investment could be repatriated. In mid-1988, the GOK amended the Foreign Investment Protection Act to define the amount of investment that can be repatriated in terms of the foreign currency of the original investment, instead of in terms of Kenyan currency. This move is favorable to investors, in that it protects the value of their remittances from depreciations in the value of the Kenyan shilling.

3.151 Remittances of all dividends, interest, principal, royalties, license fees, etc., however, are subject to Central Bank approval. There are currently no quantitative restrictions on the level of dividends which may be declared. Foreign investors still experience considerable delays (18 months or more) in remitting dividends and capital. As a result, investors face potentially large foreign exchange losses on dividends between the time they are declared and the time actual foreign exchange is allocated.

6. Land Ownership and Tenancy Policies/Procedures[16]

3.152 Land tenure laws in Kenya are extremely complex. In general, land ownership in Kenya falls into three categories: private land, GOK land, and game reserves. Land allocated to game reserves is restricted and is not eligible for development; the boundaries of the designated game reserves have remained intact since 1948, and the amount of land allocated to game reserves has grown since that time. All land in Kenya that is not privately owned is deemed to be GOK land. The Ministry of Lands and Settlement delineates all land into residential, industrial, commercial, public parks, and security zones. Intended land development which runs counter to a zoning designation must receive permission for a "change of user" status.

3.153 Almost all land in municipal areas leased from the government. Management of GOK land located within municipal boundaries is the responsibility of the Commissioner of Lands, assisted by the Municipal Councillors under the chairmanship of the municipal Mayor. Leases for allocated land within the municipal areas range from 30 to 99 years, and may be renewed. Rentals for industrial land are based upon the prevailing market price. A lump sum payment equivalent to one-fifth the assessed value of the undeveloped land must be paid by the leaseholder, and annual rents thereafter are assessed at two percent of

---

[16] The study team was not allowed to interview officials in the Ministry of Lands and Settlements, despite repeated attempts to do so. This account is therefore based on publicly available data and information supplied by the Estate Agency Association of Kenya.

the remaining four fifths of the value. This rent remains constant for the lease term.

3.154 The development of government land is subject to local government regulations and the provisions of the Land Planning Act. It has been observed that considerable delays can occur in obtaining approval for development plans on government land. At the end of the lease period, unless the lease is renewed, the leaseholds and all improvements to the land revert to the government without right of payment of compensation.

3.155 Government land which is allocated to firms or individuals must be developed within a certain number of years, as specified within the leasehold title. Failure to develop the land within this period can lead to the forfeiture of the lease right; the GOK has announced its intention to reclaim and reallocate land which is not developed in accordance with the leasehold title. To the extent that this provision may require full development of an EPZ site within a short period of time -- even in the absence of sufficient tenants and an adequate income stream to support the costs -- such a policy can be prejudicial to successful EPZ development. As evidenced in other countries -- for example, the Santo Tomas de Castillo zone in Guatemala -- initial overdevelopment undermined the financial stability of the EPZ project.

3.156 The Ministry of Lands seeks to prevent the use of land in a fashion which endangers public safety. The government has the legal authority to acquire land for public purposes in a compulsory fashion, subject to payment of compensation. It is not known whether this provision could be used to acquire land for an EPZ site, but it is believed that the GOK has not exercised that right in many years. Squatters are often allowed on GOK land but do not pose a barrier to its development; squatters are evicted without notice should the government either sell the land or need the land for its own use. A 30-day notice is required before evicting squatters on private land.

3.157 Difficulty in obtaining land is often identified as a constraint to both agricultural and industrial investment in Kenya. Land prices in and around major urban centers have been driven up as a result of growing population and industrial densities, and these increases have been further driven up by speculation. Furthermore, there are a number of restrictions on foreign land ownership. Foreigners are not allowed to own farm land or coastal property, but apparently are allowed to own industrial land.

3.158 Both the high cost of land, the lack of available land, and the possible restrictions on foreign ownership may initially make EPZ development difficult. As understood by the TSG study team, however, current land use policy in Kenya need not bar development of an EPZ, most particularly if government land in municipal areas can either be rented by, or allocated to, an EPZ developer. A minimum rental lease term of 30 years is more than adequate to support successful free zone development.

3.159 Nonetheless, a clarification of government land policy with regard to EPZ development appears to be necessary. Such a statement should clarify whether foreigners can, in fact, own land or whether such land would have to be rented from the government. Secondly, if the land is to be leased, the length of the

lease; the provisions for lease renewal; and the right of compensation for improvements to government must be clarified. Thirdly, any requirements that allocated land be developed within a short period of time must be made stated clearly. As pointed out above, such a provision is financially prejudicial to the successful development of an EPZ and the GOK may wish to address this issue in its EPZ legislation. Finally, it would be advantageous for the GOK's EPZ program if the approval time for land development plans was both specified and short; such approval could be included as part of the GOK's "one-stop-shop" investment approval process.

7. Labor Policies/Procedures

a. Legislation

3.160 There are several legislative acts that govern labor practices. The basic, overarching legislation is the Employment Act (Cap. 226). This act sets the general terms and conditions of employment for both the public and private sector, including the payment of wages; holidays and leave; contracts of service and termination; employment of women and juveniles; workers' health and welfare conditions; obligatory recordkeeping; and the like. The Employment Act is supplemented by The Regulation of Wages and Conditions of Employment Act (Cap. 229), which sets forth the machinery for determining the wages and conditions of employment by industrial category, job category, and location (i.e., Nairobi and Mombasa; other municipalities; and all other areas).

3.161 Additional important labor legislation includes the Workmen's Compensation Act (Cap. 236); the Trade Disputes Act (Cap. 234); The Factories Act (Cap. 514); and the National Social Security Act. In general, labor legislation in Kenya, and especially The Employment Act, sets forth the minimum acceptable terms of employment; additional gazetted orders can only improve on these terms. In addition, the GOK encourages private negotiations between employers and employees, with recourse to the legislation only in the case of unresolved disputes.

3.162 The Ministry of Manpower Development and Employment was created in 1988 to address Kenya's growing unemployment problems. The Ministry's responsibilities include manpower planning and development, skills inventory, Kenyanization policy, employment services, and the planning and coordination of training programs. The Ministry has taken over some of the responsibilities previously held by the Ministry of Labor, which is now responsible for industrial relations and labor matters, social security, and factory inspections. A third Ministry, the Ministry of Technical Training and Applied Technology was also recently created, and holds responsibility for technical education, vocational training, and technical training policies.

b. Unions and Wages

3.163 An estimated one third of Kenya's formal sector workforce is unionized, principally under the Central Organization of Trade Unions (COTU). Wage scales in manufacturing operations are established by collective bargaining agreements.

These agreements are signed between the unions and individual firms, usually for a two-year duration, and set forth the working terms for all employees. The contracts specify wage floors for each skill or grade level and usually provide for a specified minimum mid-contract increase.

3.164 Since collective bargaining is done on a firm-by-firm basis, the terms and conditions signed between the unions and employers can vary greatly, even within the same industry. The Ministry of Finance issues guidelines for wages and for increases in minimum wage levels. All collective bargaining agreements are drafted and registered with the Ministry of Labor prior to enactment, and each agreement is reviewed by the Ministry to ensure that wage increases do not exceed the rate of inflation. Real wage rates have been stable in recent years. In 1988, real wages grew an average of 1.9 percent, and wage rates showed no gain in 1987. Over the 1983-86 period, real wages increased at an annual rate of one-half of one percent.

3.165 Strikes are legal in Kenya, although strikes and lockouts are prohibited without prior notification of the Minister of Labor. Industrial disputes are resolved under the terms of the Trade Disputes Act, which refers such disputes to the Minister. The Minister takes action to resolve the dispute after consulting the Tripartite Committee, composed of representatives from the Ministry of Labor, the COTU, and the Federation of Kenyan Employers (FKE). The Minister may dismiss the action, make recommendations to the disputing parties, or refer the dispute to a conciliation panel (also composed of representatives of labor and industry) or the Industrial Court (whose members are appointed after consultation with COTU and FKE).

3.166 According to all those interviewed by the TSG study team, this dispute resolution machinery functions smoothly and with great impartiality. This has occurred despite the fact that there are a large number of industrial disputes each year, with over one hundred occurring in both 1986 and 1987. Many of these strikes were short wildcat strikes over local issues, or occurred in protest over the hiring of temporary workers.

c. Expatriate Employment

3.167 It is important that EPZ firms have the ability to hire expatriate labor, both in order to ensure that business operations commence in a timely and efficient fashion as well as to offset potential shortages of skilled labor. Ideally as well, investors should be granted approval of expatriate hirings as quickly as possible in order to facilitate business operations in a timely fashion.

3.168 In Kenya, responsibility for the issuance of expatriate work visas (in addition to all other kinds of visas) is lodged with the Principal Immigration Officer in the Office of the President. Each visa costs Ksh 7500 (US$364) and

is good for two years with a possible renewal for another two years.[17] As stated in the Fifth Development Plan (1984-88), the system of expatriate work permits is necessary "in order to achieve a more complete Kenyanization of the economy." The GOK encourages firms to train local personnel to fill positions held by expatriates. Accordingly, the work visa application inquires as to what steps have been taken to employ a Kenyan to fill the vacancy; whether Kenyans are being trained for the position; and whether the applicant will be instrumental in training Kenyan citizens.

3.169 According to the Principal Immigration Officer, the visa approval process for expatriates has been expedited with the establishment of the Investment Promotion Council. Investors now submit applications for expatriate work permits to the IPC at the same time they submit their investment application to the IPC. An Assistant Principal Immigration Officer sits on the IPC and is responsible for reviewing all applications for work permits. This individual approves each specific expatriate position by its specific function; for example, an industrial foreman in electronics. Reportedly, applications are rarely rejected, providing that the required skills are not available locally. The recommendations are then forwarded to the Office of the President which routinely approves them. The entire process can be completed in only a few days.

3.170 When a firm is ready to commence operations, however, any expatriate slated for a particular position must apply to the Office of the President for authorization of his/her specific visa. Since the position has already been reviewed and authorized, this simply requires a check of the individual's background to ensure that the applicant has no criminal record or that no misrepresentation has occurred. This approval process takes one month, if the application form has been properly prepared.

3.171 In practice, therefore, the IPC does not function as a "one-stop-shop" capable of facilitating the investment approval. Despite the fact that expatriate visas are supposedly approved by the IPC, discretionary authority clearly still rests with the Office of the President which conducts a further review of the candidate's background. There is no reason why this review cannot be done by the IPC, and moreover, there is no reason why this review must take another month. GOK practice in this regard compares unfavorably with successful EPZ programs around the world where investment promotion agencies truly function as one-stop-shops.

8. Other Regulations Affecting Foreign and Local Investment

3.172 Although there no specific regulations or laws requiring "Kenyanization" of businesses or investments, the government emphasizes strongly and quite explicitly the hiring or training of Kenyan nationals whenever possible. In the Sessional Paper No. 10 of 1965, the GOK stated its objective of improving the

---

[17] Local manufacturing firms have expressed a desire that initial expatriate visas be issued for a period exceeding two years, or that applications for renewal be automatically granted to employees of firms with no record of infractions.

entrepreneurial role of "African people" within the country. To this end, a number of agencies have been created, including the Kenya National Trading Corporation, the Joint Loan Boards, the Kenya Industrial Estates, the Industrial and Commercial Development Corporation, and the Kenya Institute of Business Training. In the Development Plan, 1989-1993, the government states its intention to further strengthen these institutions in order to "enable them to play an effective role in the Kenyanization of commerce." In the Plan the GOK distinguishes between indigenous Kenyan businesses, and non-indigenous businesses.

3.173 This preference is illustrated in the application forms for expatriate visas, which require an explanation of current training efforts of Kenyan nationals for any expatriate position, and is particularly stressed in the renewal of expatriate visas. Preference is given to applications by joint foreign-Kenyan ventures for the Manufacturing-Under-Bond program. Similarly, The Trade Licensing Act (Cap. 497) has been used by the government to organize commercial activity, and it is the government's intent under the current development plan to use this Act to enhance the process of Kenyanization.

3.174 Such preferences can act to deter investors in ways counter-productive to the goal of assisting Kenyan enterprises. For example, in the case of large new equity investments, Kenyan investors with a sufficient amount of venture capital may not be available to participate in joint ventures or may prefer to invest their capital in areas with more reliable rates of return. Similarly, EPZ firms are accustomed and expect to be allowed to employ expatriates in skilled senior management positions where local labor is often not available. If stringent investor requirements are maintained, employers falling short of GOK thresholds are likely to choose more favorable environments.

3.175 Another area affecting investment are corporate income taxes. Current corporate tax levels are quite high at 45 percent of corporate profits. Branch operations of foreign companies face even higher levels at 52.5 percent on branch profits. Dividend income is subject to an additional 15 percent tax rate, and a 12.5 percent withholding tax is assessed on interest earnings. In addition, a 20 percent withholding tax has been introduced on all payment of management fees to nonresidents. GOK practice to date has been not to grant tax holidays are granted to foreign businesses.

3.176 By contrast, most EPZs offer far more generous tax levels or even complete tax holidays. Mauritius has one of the higher tax levels, at 15 percent for the life of the company, but countries such as South Korea and Costa Rica offer 100 percent exemptions for 5 to 6 years, while the Dominican Republic offers a complete tax holiday for 8 to 20 years. Moreover, these high levels of corporate taxation make Kenya an unattractive investment site even when compared to a number of non-EPZ less developed countries; for example, normal corporate tax rates are 33 percent in Singapore, 20 percent in Taiwan, and range up to 40 percent in Honduras.

E. KENYA'S COMPETITIVENESS AS AN EPZ LOCATION

1. Basic Factors of Production

3.177 Weighing Kenya's assets against its liabilities as a location for EPZ development, the country emerges in a net positive position in terms of the basic factors of production. Many of the fundamental requirements for successful EPZ development are in place, including readily available and low-cost labor, above-average physical infrastructure, good geographic location, and political and social stability. The frequency of air and shipping voyages are favorable. In particular, the costs of Kenya's electricity, water, telephone, and freight services are highly competitive with other EPZ programs, while the cost of industrial land is inexpensive relative to other existing or potential EPZ countries in Africa, such as Togo and Mauritius.

3.178 A number of negative factors, however, do exist. Port handling costs are high relative to other EPZ locations. This disadvantage is further negatively compounded by the inefficiency, corruption, and disrepair characterizing the port at Mombasa, and by the substantial delays reported in the shipment of containers between Mombasa and Nairobi.

3.179 On a more subjective level, there are a number of trends which will be potentially be perceived by foreign investors as highly negative in nature: excessive tribalism and favoritism towards Kenyan African firms; persistent budget and current account deficits; double-digit rates of inflation; and, to some degree, a lingering suspicion of foreign investment. Given the internationally competitive nature of EPZ investment, the GOK must ensure that these latter factors do not overshadow the overall -- but not overwhelming -- competitiveness of the country's basic factors of production.

2. Institutional and Regulatory Policies

3.180 The principal obstacles to EPZ development, relate largely to national policies and procedures. Corporate tax levels are high, the limits on local borrowing by foreign firms are highly restrictive, and the limits on access to foreign exchange compare extremely unfavorably to other countries. The GOK land policy as it affects EPZ development is unclear. Likewise, the bureaucratic complexity of investment in Kenya, the difficulties associated with export and import procedures, the delays and corruption associated with Customs procedures, and the substantial weaknesses of the Export Compensation and Manufacturing-Under-Bond schemes not only militate strongly against successful EPZ operations, but threaten to deter investors entirely. Again, it must be remembered that bureaucratic complexity of business operations in Kenya will be measured on a comparative basis with other investment sites, and it is only by equalling or bettering administrative procedures in other countries that Kenya can hope to capitalize on its favorable basic factors of production.

3.181 National policies and procedures, however, are under the control of the GOK. Based on the TSG team's international experience, combined with the comments of public and private sector representatives interviewed during the course of this study, the project team is convinced that, given the proper set

of policies and institutional arrangements, Kenya has the potential to develop a successful EPZ within a relatively short period of time. The challenge will be to capitalize on the country's major comparative advantages, while avoiding the implementation difficulties that have plagued previous policy initiatives.

3.182 One notable conclusion to be drawn from the TSG team's interviews and analysis is the failure of current export incentive measures to provide the type of comprehensive "package" which has been instrumental to successful EPZ development in other locations. Foreign investors, in particular, are unlikely to find the current incentive regime sufficiently attractive to induce them to undertake new export-oriented investments.

3.183 A point raised by almost every private sector representative interviewed by the project team was the need for a streamlined implementation mechanism. Given the experience of past export promotion initiatives, it appears that GOK will face two distinct challenges with respect to EPZ development. The first will be to develop a policy package that is attractive enough to overcome existing constraints. The second will be to implement the package in an efficient and transparent manner.

IV. EPZ MARKET AND DEMAND ANALYSIS

4.01 Recent developments in global markets, production technologies, and corporate investment strategies are affecting the character and composition of operations in Export Processing Zones. After examining trends in key end-user markets, this chapter examines patterns of global sourcing that are occurring in sectors of high potential for Kenyan EPZs. The discussion then reviews recent investment trends in Kenya, in light of these global patterns to arrive at a preliminary determination with regard to the likely sources and sectors of investment in a Kenyan EPZ.

A. ASSESSMENT OF THE END-USER GLOBAL MARKETS FOR EPZ PRODUCTS

4.02 The potential for successful development of an EPZ program in Kenya, as in any country, is affected by a broad spectrum of economic and institutional factors, as discussed in the preceding chapter. Equally important in assessing Kenya's EPZ prospects are conditions affecting the market for the goods and services to be produced within the EPZs. This section discusses the markets and trade patterns of greatest relevance to the Kenyan EPZ program, noting both the constraints imposed by non-tariff trade barriers in some market segments and the opportunities created by preferential access agreements in others.

1. Overview of Key EPZ Export Market Opportunities

4.03 Over the past decade, EPZs in low and middle-income developing countries have oriented towards three major end-user markets: apparel, electronics/electrical products and leather goods/footwear. In addition, food processing industries have large potential for countries such as Kenya where agricultural production is already an important part of the economy. EPZs in more advanced developing countries and in Newly Industrialized Countries (NICs) have also successfully targeted markets for scientific and other precision instruments, pharmaceutical, and information processing, but these markets have characteristically been penetrated after zones have gained experience in more traditional EPZ markets. This section, accordingly, examines end-user markets and trade patterns in sectors of greatest near-term potential for countries, such as Kenya, now embarking upon EPZ development.

2. Structure and Trends of End-User Markets

a. Apparel Markets

4.04 Overview of World Trade. Markets for apparel manufacturing and assembly continue to be among the primary engines of EPZ expansion world-wide. An analysis of world trade patterns indicates the dimensions of the market opportunity for apparel firms operating in EPZs. Growth in the value of world trade in apparel accelerated an estimated 27 percent in 1986 over the 1985 growth rate, fueled by increased consumer demand in the United States (6.5 percent) and in the EC (3 percent); a recovery in the growth of exports from the Far East: and the

effect of exchange rate fluctuations on the unit values of apparel products. Total worldwide apparel imports equalled US$62 billion in 1986. Import value growth, on average, outpaced export growth in the two largest markets, North America and Western Europe which together consume 80 percent of all apparel goods exported globally. World trade in clothing during 1986 not only expanded twice as fast as total merchandise trade, but also faster than the 20 percent increase in world exports of manufactures.

4.05 With respect to worldwide imports, the most notable development in world apparel imports during the 1980s was the sharp increase in the relative importance of North America, with counterpart declines in the import shares of other significant markets.

4.06 In value terms, over three quarters of world apparel exports originate in Western Europe, China, Hong Kong, South Korea, and Taiwan. Despite year-to-year fluctuations in the 1980s, four East Asian economies have captured increasingly larger market shares of world trade, with corresponding declines in those held by Western Europe and North America. The market position of developed countries has been continually eroded since 1970.

TABLE 4-1
Shares of World Clothing Imports, Selected Countries, 1986
(percentage value share of total worldwide imports)

USA	30.26
West Germany	16.88
France	6.73
USSR	5.95
UK	5.65
Netherlands	4.81
Japan	4.61
Hong Kong	4.09
Switzerland	3.45
Belgium-Luxembourg	3.16
Canada	2.48
Sweden	2.46
Austria	2.09
Italy	1.88

Source: EIU World Textile Trade and Production Trends #1108

4.07 The developing countries' share of total worldwide exports was 12 percent in 1986, basically unchanged since 1980. 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.

4.08 In 1986, the market share held by LDCs had expanded to 23.5 percent of clothing imports into North America and 11.5 percent of total West European imports. In contrast, LDC imports of clothing (including the oil-exporting nations in the Middle East) have declined since 1983, due in most part to the decline in demand from Middle Eastern markets suffering from an oil-based recession.

4.09 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. Its objective is to facilitate the liberalization and expansion of global textile trade while avoiding major disruptions in individual markets. The treaty is implemented by means of bilateral agreements regulating imports of textiles/apparel when domestic markets were threatened with "disruption." Base quotas are established to reflect the historical performance of exports, with allowances for positive growth negotiated individually. To ensure further flexibility, provisions are included allowing for "carryforwards" of unused quotas from year to year and "carryovers," or advances of quota allocations from the coming year. New quotas can be phased in for products not already covered by the MFA between signatory countries as market developments warrant.

4.10 In practice, the disruption provision of the MFA has been used by developed countries in an increasingly protectionist fashion as growth restrictions have become more stringent, particularly for the U.S.' "Big Three" -- Hong Kong, South Korea, and Taiwan. The United States and the European Community have both used the MFA as a means to protect sensitive domestic markets, and have effectively punished successful exporters by placing low ceilings on their quota allocations.[1] While opportunities clearly exist for developing countries to utilize the apparel sector as a springboard for export diversification, under the firmly entrenched MFA the industry is one of the most heavily regulated in the broad spectrum of international trade.

4.11 The U.S. Market. The United States is the largest importer of apparel products in the world. The value of apparel industry shipments (both imports and domestically produced goods) in the United States in 1987 totalled over US$60.9 billion. Apparel imports exceeded US$19 billion, while only US$1 billion were exported. Since the 1970s, total domestic consumption of apparel has grown

---

[1] A recent World Bank working paper (Erzan, Goto, Holmes, 1989) argues that it is not only the well-entrenched exporters that are increasingly faced with restrictions under the arrangement, but that new non-restricted entrants to the market are also faced with tight quota allocations as soon as they show promise in their exports. Such countries are consequently forced to diversify into new product categories early on if they wish to increase their export levels. Consequently, the study found the primary beneficiaries of the arrangement have been the domestic producers in the importing countries rather than new developing suppliers capturing trade diverted (restricted) from established exporters.

modestly, at less than 1.2 percent annually, during which time the market share of domestically produced goods declined rapidly relative to imports. From 1976 to 1986, import penetration increased from 12 percent to 35.6 percent of total sales in value terms.

4.12 Particular apparel items have increased substantially with regard to import penetration. In 1986, the dominant imports were sweaters; women's blouses, slacks, and coats; men's shirts; and children's coats. The tremendous inroads made by imported apparel products over the last decade have stimulated a number of structural changes, as the U.S. apparel industry attempts to remain competitive, such as:

- U.S. quotas governed by the MFA have been tightened. The United States now has 21 bilateral agreements covering over 90 percent of its apparel imports. In 1987, a one percent ceiling was placed on the annual value growth of U.S. apparel imports from Far Eastern suppliers.

- U.S. apparel manufacturers have begun to source, import, and manufacture both apparel components and finished goods from low-cost locations offshore with excess quota availability.

- Far Eastern manufacturers facing the imposition of highly restrictive quotas have moved to other low-cost locations with access to the U.S. market. The immediate beneficiaries of this trend have been the countries of South Asia and the Indian Ocean (Sri Lanka, India, Bangladesh, Indonesia, Thailand, and Mauritius).

- There has been a strong trend in Far Eastern exports to the United States away from low-end, low profit margin apparel goods towards higher quality, better styled adult wear in response to quotas on man-made fiber apparel.

4.13 The highly competitive environment in which apparel manufacturers are operating is not expected to diminish over the medium term. In the United States and Europe, anticipated demographic changes -- as the most important age group among apparel consumers (35-54) increases in size and affluence -- are expected to fuel growth in demand for all types of apparel products. Furthermore, many U.S. manufacturers are reportedly experiencing substantial cost increases from their Far Eastern sourcing operations due to the declining dollar and more expensive fabric and labor, and are subsequently devising strategies to protect their market share. Such strategies generally include: investigating low-cost labor locations for expansion or relocation; introduction of more sophisticated technology to reduce the labor component of production; and increasing reliance on subcontractors as an alternative to direct investment. On balance, these factors bode well for increased offshore investment by U.S. apparel firms.

4.14 The European Community. The EC has preferential trade agreements with a host of developing countries throughout the world, primarily the former colonies of its members, such as Kenya. Over the years, a significant number of trade barriers have been lowered, especially with respect to member nations of the Lomé I, II, and III Conventions. The Lomé Conventions seek to support LDC development

efforts through a combination of trade and foreign aid programs. However, Lomé III apparel agreements are subject to the parameters established by the MFA agreements, as discussed above.

4.15 Western Europe, and in particular the nations comprising the EC, is a large and expanding apparel market. In 1986, imports of apparel products totalled US$25 billion, an increase of 43 percent over the 1985 level. Imports were heavily dominated by intra-regional trade, comprising two thirds of the total import bill, with the remaining one third of imports originating from the Far East. The principal apparel trading nations within the EC have experienced moderate real growth in apparel imports in the 1980s. This was due to several factors: growing reliance on imported apparel and textiles due to decreasing competitiveness and currency appreciation; an opposing decline in domestic production; and decreasing domestic demand due to a general economic slowdown.

4.16 In general, apparel manufacturing in the EC concentrates on medium or high-end products which exhibit world-class quality and design, while imports comprise more traditional products embodying a low value-added component. In individual cases, these generalities dissolve; for instance, France and Italy are renowned fashion centers specializing in the export of upscale designer wear, whereas Spain and Portugal, newly emerging apparel exporters, are focusing on established low-end markets in the EC.

4.17 West Germany is the largest overall trader in the EC, having imported US$10.4 billion and exported US$4.2 billion worth of apparel products in 1986. From 1980 to 1985, annual growth in volume imports averaged two percent, while in 1986 the growth in volume imports jumped to over 12 percent. The rate of import growth in dollar value in 1986 exceeded 33 percent, after experiencing negative growth of almost six percent from 1980 to 1985. As evidenced by the figures, currency appreciation had a significant impact on the dollar values of exports and imports. At the same time, real growth in imports was positive and significant. The key exporters of low-end apparel products to the West German market continue to be the leading Asian producers -- Hong Kong, South Korea, China and Taiwan, although their market share in dollar value terms has declined every year since 1980.

4.18 The German deutschemark's appreciation in relation to the dollar has continued into 1987, and West German exports are expected to become increasingly uncompetitive relative to Far Eastern products; West German apparel imports have already been accelerating. However, a shrinking German population, increasing unemployment (currently nine percent), and declining consumer spending could constrict apparel import growth in the near future. The opportunity still exists to capture market share in West Germany as a step toward future penetration into other EC countries in the supply of apparel products. As West Germany raises its quota restrictions on Far Eastern exporters, other low-cost nations with preferential access will be in a unique position to effectively penetrate the apparel market.

4.19 The United Kingdom represents a large national market in apparel, with imports in 1986 totaling US$3.5 billion. Import growth rates in terms of volume from 1980 to 1985 were modest at four percent annually, leaping to over 16 percent in 1986, while import growth rates in dollar value exceeded 30 percent.

Overall, the U.K.'s total consumption of apparel has increased, due in part to rising standards of living and subsequent increases in consumer spending.

b. Electronics/Electrical Goods Markets

4.20 Electronics manufacturing and assembly firms have played a major part in the evolution and diversification of EPZ industrial activity. Zones throughout the world, especially in the Far East, have succeeded in attracting electronics manufacturers after establishing export operations in other industries such as apparel/textiles and other light manufacturing.

4.21 The electronics industry is comprised of five basic sub-sectors: automatic data processing machines; telecommunications equipment; consumer electronics, electronic components, and business electronics. The product categories most suited for offshore production have proven to be electronic components and consumer electronics, and to a lesser extent, telecommunications equipment. Electronic components are the building blocks for all electronics products, ranging from radios to telecommunications equipment and business computers. Component manufacture involves the production of either "active" or "passive" electronic parts and intermediate devices (although some components integrate both). Passive components comprise resistors, capacitors, switches, relays, printed circuit boards, and electron tubes. These relatively simple items embody more standardized design and labor-intensive production processes and can be used in a variety of applications. Passive components are thus suited to offshore production and are the focus of this profile. Consumer electronics utilizing passive components include radios, cassette players, electronic clocks, television sets, video recorders, and telecommunications equipment.

4.22 Overview of World Trade. Total world exports for all electronics products reached US$164 billion in 1986, a 21 percent increase in value over 1985. This industry was one of the fastest growing in all world merchandise trade, partially due to exchange rate movements. Although demand declined in West Germany and the United Kingdom, the largest markets in the EC, West Germany nonetheless continued to record the highest level of export and import growth within the region. Among LDC exporters, the marked appreciation of the yen against the dollar improved their competitiveness, especially in standardized consumer electronic products and components which compete directly with Japanese products.

4.23 The share of electronic products in relation to total world trade increased from 4.4 percent in 1980 to 7.6 percent in 1986. Outstanding performance occurred in exports of automatic data processing equipment (consisting of computers and related equipment), growing by 24 percent to reach US$55 billion. This product category is highly competitive, but relies on innovation and performance, as well as cost. Export market growth was led by Far Eastern firms, whose exports grew by over 50 percent. The rate of growth in exports of telecommunications equipment tripled from seven percent in 1985 to over 24 percent in 1986, reaching US$28 billion. The exporting leaders -- Japan, the United States, and the EC -- accounted for most of the value growth due to increased worldwide demand (especially in Europe) for all types of equipment.

4.24 The value of world exports of consumer electronics expanded by almost 17 percent in 1986 to reach US$28 billion. Exports from Western Europe and South Korea expanded by nearly 60 percent, while Japanese exports (more than 50 percent of total consumer electronics exports) grew by less than five percent, due to several factors: the appreciating yen, a fall in exports to China and the Middle East, and the impact of industrialized country protectionist measures on consumer electronics. Responding to these actions, Japanese manufacturers have moved offshore to both industrialized and LDC locations to maintain competitive positions.

4.25 World trade in electronic components (including semiconductors) experienced a marked increase in 1986, as imports recovered by more than 22 percent after a 10 percent decline in 1985. The growth can be attributed to a strong expansion of U.S. exports; and a significantly higher growth for EC imports compared to 1985.

4.26 Trade data reflecting actual shipments of goods across borders, rather than treating foreign subsidiaries as part of the parent company's "domestic industry," reveal the importance of LDCs and NICs as manufacturing locations. These countries exported almost US$6 billion worth of active components in 1986, while the United States, Japan, and the EC exported US$2 billion, US$3.1 billion, and US$3.2 billion, respectively. The industry composition has changed in recent years as developed country firms have forged alliances with offshore manufacturers to reduce costs, solidify market position, and gain access to product markets.

4.27 The U.S. Market. The United States imported just under US$11 billion worth of components alone in 1987, representing a growth rate of 17 percent over 1986. The increase was largely due to strong demand from the computer and defense industries. The manufacture of components was estimated to have grown at least 10 percent per annum over the next two years. Approximately half of all U.S. trade is generated from offshore manufacturing in the Far East and Mexico. Indicators for 1988 show that many U.S. manufacturers are now engaged in foreign joint ventures to enhance competitiveness.

4.28 The market for capacitors is especially strong, with a projected growth over the next few years to exceed 1987 growth of five percent. The automotive, computer, and telecommunications industries were the biggest end-users of these components in 1987. Shipments of electronic coils and transformers (used in household electronics, computers, etc.) were also accelerating substantially, up six percent from 1986 to US$1.3 billion, most of which originated in low-cost labor locations. Growth in U.S. imports of electron tubes, connectors, and resistors are likely to be modest over the near term.

4.29 In general, the long-term prospects for penetration of the U.S. market are excellent. The moderate growth rates for traditional passive components and consumer and business products, coupled with rising interest in offshore manufacturing from U.S. firms, bodes well for LDC EPZs as domestic component manufacturing operations are increasingly vulnerable to price competition from the Far East. Moreover, beneficiaries of the U.S. GSP program can receive duty-free market entry on the value-added abroad for certain electronic products and components. Protectionist actions to date have been limited primarily to

semiconductors and aimed at Japanese manufacturers; access for LDC exports should remain open.

4.30 European Community. The twelve nations of the European Community exported US$62 billion worth of electronic products in 1987, a 26 percent increase over 1986 levels and well above the nine percent annual average rate of increase recorded in the 1980-86 period. Imports (including intra-Community imports) totalled US$72 billion in 1987, up from US$56 billion reached in 1986.

4.31 Since 1982, the European electronics industry has been experiencing a dramatic period of growth. As part of this growth, intra-Community trade in electro-technical goods has been substantial; this trend is likely to continue with the creation of a single market in 1992. As a group, the 12 nations of the EC comprise the single largest import market in the world. Imports of electronic products into the EC increased by some 26 percent in 1987, about the same percentage as in 1986. Most EC imports are concentrated in the automatic data processing sub-sector, but in 1986 the EC imported over US$8 billion of electronic components from outside the Community. The leading importer of electronics in the EC was West Germany, followed by the UK, France, and Italy.

4.32 More than US$7 billion of switchgears and related products were imported by the EC countries in 1987. From a technological perspective, this sub-sector represents the low-end of the electronics industry, but it includes the type of products most likely to be manufactured in an EPZ. Table 4-2 shows the top five EC importers of these products and their major import sources. The import market is heavily dominated by West Germany, and in general, European firms are the most important. Japan supplies only about 6.6 percent of the imports by these five countries, while the U.S. provides about 12.7 percent.

4.33 Within the passive components sub-sector, connectors account for nearly one third of the market. Printed circuits account for almost 25 percent, while capacitors and resistors combined account for another 25 percent.

4.34 In mid-1988, there were some 16 arrangements limiting exports of electronic products, including some machine tools, to the EC member states. Given that there were only nine such agreements in early 1985, it appears that there is an increasingly protectionist sentiment within the Community, largely directed at Asian exports of finished consumer electronics. Japan and South Korea, for example, both monitor their exports to the EC; South Korea restrains its exports of video tape recorders, while Japan limits exports of color television sets and tubes, as well as video tape recorders. In addition, individual member states have import restrictions to protect their domestic markets; for example, France restricts imports of color televisions from Japan to 84,000 units per year.

4.35 Electronics production is consumed by a wide variety of users. The largest consumer, however, is the electrical industry itself, for a large proportion of electronics output is used by the industry as primary or intermediate inputs. As a result, the industry as a whole is very highly integrated. The industry sub-sector of passive electronic and electro-mechanical components is comprised of many small and medium-sized companies located in each major European country. A few products, such as capacitors and connectors, are dominated by a few

TABLE 4-2

Leading EC Importers of Switchgears and Related Parts, & Major Import Sources, 1987 (by country and value in US$ millions)

Country	Import Source		Value
WEST GERMANY	1.	Switzerland	333.4
	2.	France	279.6
	3.	U.S.	229.5
	4.	Japan	208.1
	5.	Austria	151.5
UNITED KINGDOM	1.	West Germany	434.4
	2.	U.S.	320.6
	3.	France	180.8
	4.	Japan	164.6
	5.	Switzerland	82.9
FRANCE	1.	West Germany	621.4
	2.	U.S.	157.4
	3.	Italy	116.8
	4.	United Kingdom	78.7
	5.	Japan	75.7
ITALY	1.	West Germany	511.7
	2.	France	218.1
	3.	U.S.	94.7
	4.	Switzerland	70.1
	5.	United Kingdom	49.8
NETHERLANDS	1.	West Germany	313.5
	2.	Belgium/Luxembourg	91.9
	3.	U.S.	62.4
	4.	France	59.0
	5.	United Kingdom	41.7

(N.B. This data excludes Taiwan; totals therefore understate total import levels.

Source: United Nations, International Trade Statistics;

multinational firms, while others are produced by a large number of manufacturers.

4.36 The marketing of electronics products within the EC varies from country to country. In West Germany, trade fairs play an important role in the successful marketing of electronic products and components. Within the United Kingdom, trade fairs are useful in getting maximum exposure to the overall

market, but direct contact with end-users is more fruitful in actually placing orders. In the final analysis, product acceptability is the key to market access in the U.K., with diversity, price, and delivery as the most important attributes in the passive component category. Throughout the EC, LDC manufacturers with links to U.S. or West European firms will likely have an advantage in establishing credibility with industry buyers.

4.37 Near-term demand in the Community for electrical and electronic products is expected to grow at a steady 3.5 percent per year. This growth will translate into sustained overall growth in the demand for the electronics components that are inputs into these products. Growth is expected to continue to be favorable as the introduction of technology-intensive production methods continues. A slightly increased proportion of domestic demand will be met by imports from outside the Community as European electronics manufacturers look abroad for cheaper sources of electronic inputs. The best prospects for exports of passive components to the Community are in West Germany, the U.K., and France.

c. Processed Fruit and Vegetable Markets

4.38 Fruit and vegetable processing is a sub-sector of agro-industry, the term used to describe the commercial production and distribution of agricultural products. The spectrum of activities encompassed by agro-industry is extremely broad, ranging from the simple packaging and sale of primary food products for local cash markets to the large-scale, complex processing and international trade of high value-added products. Given the immense scope of this sector, this profile does not attempt a comprehensive examination, but instead focuses on one type of processing activity: the production of processed fruits and vegetables, including such products as juices, frozen concentrate, and canned products. The processing of fruits and vegetables is one of many agro-activities that can potentially benefit from locating in an EPZ, capitalizing on the availability of local raw materials in the production of export goods.

4.39 Fruit and vegetable processing includes those businesses engaged in the substantial transformation of fruits and vegetables into food products such as canned food, frozen food, packaged dinners and snacks, etc. Because consumers are becoming increasingly reliant on convenience in food preparation, fruit and vegetable processors are experiencing rapid growth in sales of convenience foods, such as processed and frozen vegetables, aseptically packaged juices, and prepared sauces. Technological innovations such as heat processed packaging and quick-freeze techniques are making prepared meals and dishes available to affluent customers worldwide.

4.40 The U.S. Market. The United States is the second largest consumer of agricultural products after the EC, and it is also one of the largest agro-producers in the world. In 1984, total consumption of food products in the United States exceeded US$300 billion, and fully 50 percent of all food sales were frozen foods. In 1950, processed fruit accounted for 42.8 percent of the total U.S. fruit consumption; in 1982, this figure had risen to 60.2 percent. Corresponding data for processed vegetable consumption in the United States shows an increase from 42.2 percent in 1950 to 50.4 percent in 1982.

Canned vegetables remain the dominant form of processed vegetable consumption. Although several categories within the sector are thriving (ethnic foods, sauces, soups, etc.), overall growth in the product sector has been stagnant, however, since 1975. On the other hand, fresh and frozen vegetable consumption increased two and three percent annually, respectively, between 1970 and 1985.

4.41 Since 1970, selected citrus products have led the growth of the processed fruit and vegetable sector in the United States. The total use of citrus items has shown moderate growth relative to other processed fruit and vegetable categories. Demand for frozen citrus items was much higher, however, increasing almost 100 percent over the same period. Frozen orange juice concentrate grew 4.6 percent annually between 1970 and 1985 and aseptically packaged chilled juice has also recently experienced a significant increase in demand.

4.42 The share of the market held by imported processed fruits and vegetables and citrus in the United States is growing. U.S. imports of canned foods and frozen foods exceeded US$2 billion in 1987, up 3.5 percent over 1986. In 1987, six products were responsible for 50 percent of the fresh and processed fruit and vegetable imports: orange juice (20 percent), apple juice (9 percent), mushrooms (7 percent), pineapples (7 percent), olives (4 percent), and tomato products (3 percent). Imports are comprising an increasingly larger share of U.S. consumption of processed foods, although at a moderate rate. U.S. imports of citrus products have been aided in the 1980s by several freezes in the citrus groves of Florida which have not only diminished U.S. exports, but increased reliance on imports for domestic consumption.

4.43 <u>European Community</u>. Taken as a whole, the European Community is the world's largest consumer of processed fruit and vegetable products, followed by the United States. The majority of agricultural products consumed by the European Community, however, are produced within the region and traded internally; therefore the market for imported (extra-regional) goods is actually much smaller than consumption statistics indicate. Intra-regional transfers, for instance, account for fully 70 percent of EC member nation exports. In 1986, the EC imported nearly US$5.4 billion in fruits and vegetables from outside the Community.

4.44 The principal reason behind the self-contained nature of EC agricultural trade is the regional trade barriers that have been erected to protect agro-producers in member nations. Under the Common Agricultural Policy (CAP), the EC regulates agricultural prices, structural improvements to agriculture, and internal and external agricultural trade. In 1986 (and as an historical average), agricultural subsidies and support mechanisms account for approximately 70 percent of total EC budget outlays; this is equivalent to nearly half the total revenue of EC agricultural producers.

4.45 In an effort to cut costs, the EC has recently made moves toward reducing the level of subsidy offered to its agricultural producers by implementing production quotas to stem the surplus production of basic commodities such as grain and dairy goods. The EC is a net exporter of agricultural products, however, based almost entirely upon the provision of export subsidies.

4.46 The primary importer of fruits and vegetables within the EC is West Germany with imports of over US$6.11 billion in 1986, a 23 percent rise in value over 1985 levels; followed by France (US$3.22 billion), the United Kingdom (US$3.20 billion), and the Netherlands (US$2.09 billion). On an individual basis, and for the EC in aggregate, imports of fruits and vegetables are increasing, growing from US$13.52 billion in 1984 to US$17.91 billion in 1986, an increase of 25 percent. West Germany is also the largest EC market for fruit juices with nearly 15 percent of the world total in 1981, followed by the U.K. with 10 percent.

4.47 In similar fashion to U.S. consumers, West European consumers are showing increasing interest in aseptic "carton-packed" fruit juices, which offer the benefits of a long shelf life without refrigeration and the metallic taste which often characterizes many canned products. Over half of the fruit juice sold in several major European markets today is packed in these cartons, and the product's convenience is credited with contributing to the growth in consumption.

d. Markets for Leather/Footwear Products

4.48 Overview of World Trade. Consumption of footwear products in total and by product category varies widely between industrialized and developing countries. The United States is the world's largest single country market for both total and imported leather footwear, consuming 566.5 and importing 461 million pairs of leather shoes in 1987. EC countries occupy five spots among the top ten importers of leather shoes; the EC as an aggregate market recorded total import volume of 393.4 million pairs in 1987, although much of the activity represents, again, internal trade among member EC countries. The USSR and Canada are also significant importing nations, recording 73 and 23 million pairs, respectively, while Hong Kong recorded 19 million pairs, almost all for re-export.

4.49 Although many nations evidence high levels of import volume of leather shoe products, consumption figures (representing domestic production plus imports minus exports) indicate that much of the import volume in some cases is re-exported to other end-user markets. East Asian producers, for instance, typically record high import levels, although countries such as South Korea, Taiwan, and Hong Kong re-export most imports. On the other hand, industrialized countries in North America and Europe consume most imports of leather footwear. EC countries consume a majority of intra-EC produced products, though increasingly East Asian leather shoes as well.

4.50 The U.S. Market. In value terms, per capita nominal consumption rose 2.5 percent in 1988 to US$27.1 billion, however, personal consumption expenditures on footwear in constant 1982 U.S. dollars declined in 1988 by 2.9 percent. Annual personal consumption expenditures on total footwear products in the United States averaged US$111 per capita in 1988. Over the 1960 to 1987 period, total personal consumption expenditures as measured in real U.S. dollars grew at 3.5 percent per annum. During that same period, personal consumption of clothing and shoes together and shoes alone grew at an average annual compound rate of 4.2 and 3.0 percent, respectively.

4.51 In the past ten years, the trend of personal expenditures has been particularly divergent, with total consumer expenditures expanding less than three percent per annum while expenditures on clothing and shoes in total and shoes only grew at an average real annual rate of 5.0 and 4.5 percent for the 10-year period, respectively. However, footwear expenditures as a percentage of total clothing and shoe expenditures over the past 27 years hit a record low in 1984 at 14.95 percent, but have since risen to 15.6 percent as of 1987. Furthermore, footwear expenditures as a percentage of total consumer expenditures have risen more dramatically since 1976, reaching 0.98 percent in 1987. These data suggest that although footwear expenditures in real terms have declined in the past three decades, recent trends indicate a small but significant reversal.

4.52 Between 1977-87, footwear product classes evidencing the highest compound annual rates of volume growth were athletic shoes, a miscellaneous category (other shoes), and women's shoes. Youths' and boys' shoes evidenced negative rates of volume growth over the same 10-year period, as did work shoes and slippers. Only marginal volume growth was recorded in men's and infants' and babies' footwear.

4.53 Import penetration in these categories over the period has risen substantially in all categories except slippers. Import penetration has been particularly strong in men's and women's categories, where over 60 percent of footwear purchases occurred in 1987.

4.54 Total volume consumption of non-rubber footwear in the United States in 1988 declined approximately five percent to an estimated 1098 million pairs from 1148 million pairs in 1987. Offsetting the reduced consumption of non-rubber footwear, however, was an increase in consumption of rubber/canvas footwear (sneakers primarily). In response to increased demand, imports in 1988 of rubber footwear increased 24 percent accompanied by a domestic production increase of 28 percent measured in volume terms. The result of these trends was an increase in consumption of almost one pair of rubber/canvas footwear per capita in the United States during the year.

4.55 Imports of leather shoes have grown at a compound annual rate of 14.7 percent since 1983. Combined with only marginal growth in footwear consumption over the past several years, continued import leather product penetration has consistently eroded domestic market share, and production of leather shoes has consequently declined along with exports due to intense competition in world footwear export markets.

4.56 The price of hides and leather has risen during 1988, thereby leading to increases in most prices of leather shoe products. Nonetheless, consumers in the United States have continued to prefer leather over other materials, and despite the average rise in prices, have increased consumption in volume terms slightly.

4.57 <u>The European Community</u>. The Community's total footwear market was valued at US$16.2 billion in 1986, corresponding to volume consumption of 1.25 billion pairs. Overall consumption per capita in 1986 was 4.2 pairs, with significant variances between high consuming member nations such as France and lower per capita consuming nations such as Spain. The slow real growth of EC population

and of household consumer purchasing power since the early 1980s has accounted for the overall marginal growth evident in the footwear market in the EC, with volume consumption for all footwear products increasing at a compound annual rate of only 2.2 percent between 1982 and 1987.

4.58 The aggregate EC market in 1987 consumed an estimated 705.7 million pairs of leather footwear among the 12 member countries. The largest consumers were West Germany, France, the United Kingdom, Italy, Spain, and Belgium. An examination of leather footwear import levels illustrates the strong divergences between countries in capability of competitively supplying their own markets with products.

4.59 As import penetration increases, the national markets for leather footwear are declining in volume while the growth of imported leather shoes has evidenced high real rates. In the case of France and the United Kingdom, imports and domestically produced goods roughly share the national markets, although again import growth has far outpaced the growth of consumption in each individual market. Import-reliant countries such as West Germany and Belgium have proportionately small domestic leather production activity in relation to total national market size. Imports comprised 83 and 105 percent of apparent leather footwear consumption (including re-exports) in 1987 for West Germany and Belgium, respectively. As is the case throughout the EC, imports into these two countries expanded significantly while market size remained stagnant in volume terms.

4.60 As an aggregate market, apparent consumption in the EC in volume terms grew at a slow rate between 1983 and 1987, with a notable increase between 1986 and 1987. Imports during the same period expanded 6.2 percent, again with a small surge during 1987. Preliminary data for 1988 suggest that these trends in consumption will continue, and import growth may progress in the face of adverse currency movements affecting the competitiveness of intra-EC produced leather shoes.

4.61 Product category trends within the EC are, as expected, varying among member countries. In France and Italy, imports of leather footwear, as measured by volume, are comprised of principally women's and men's shoes. Of the two categories, men's leather shoes has evidenced the highest rates of import growth in France since 1983, while imports of women's shoes in Italy have recorded stronger growth. Children's leather shoes have shown marginal rates of growth for imported products, as has apparent consumption for the two countries.

4.62 In West Germany, the consumption of men's and women's leather shoes has risen significantly over the past several years, with the increased market share being captured by imported goods. Imports of leather children's shoes have also increased rapidly, though consumption has risen only slightly, having been mostly offset by reductions in domestic production. The U.K. market, on the other hand, has recorded generally marginal growth in both consumption and imports of women's and men's shoes in recent years, although the mid-1980s witnessed more active demand.

3. Preferential Market Access Agreements

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

U.S. Generalized System of Preferences. 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;[2] (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. Selected products are excluded from GSP duty-free benefits because of the potential adverse impact upon domestic U.S. industries. Such products include: textile and apparel products subject to textile agreements; watches; certain import-sensitive electronic articles; import-sensitive steel articles; footwear, flatgoods and leather wearing 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.

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 $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

---

[2] 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.

offshore for re-import to the U.S. under the program. In 1987, the total value of U.S. 9802 imports was US$68.5 billion, of which 54 percent were from Mexico, followed by 14 percent from Canada, 10 percent from various Caribbean Basin countries and 12 percent from various Asian countries including Japan, Malaysia, Philippines and Singapore. Unlike the U.S. GSP program, the 9802 provisions cover apparel and textile products.

Lomé Convention. Beneficiaries of the Lomé III 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.[3] Free access is also granted to some products which contain non-ACP or non-EC sourced materials, if such materials do not account for more than five percent of the total material costs and if certain types of processing have been carried out. Sufficient processing is generally defined to have occurred if it produces a product with a different tariff heading. The Convention, however, guards against misuse of duty-free access by non-ACP countries seeking to avoid trade tariffs or other entry restrictions. Thus, the simple assembly of non-originating parts to make a complete item, or the repackaging of items, does not constitute sufficient processing to qualify for duty-free entry, even if it results in a different tariff heading.

European Generalized System of Preferences (EC/GSP). This program of the European Economic Community is similar to that of the United States, offering 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.

4.64 In addition to these programs of global scope, the Preferential Trade Area (PTA) is a regional trade agreement within the African community to which Kenya is a signatory.[4] Signed in 1982, the treaty did not become operational until July 1984 with the initiation of tariff reductions on intra-PTA trade. Its membership is comprised of 20 Eastern and Southern African states with a total population of some 180 million.

---

[3] Member states are the 66 ACP nations which are signatories to the Lomé Convention.

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

4.65 The provisions of the treaty are quite broad, encompassing an integrated program for promoting the economic development of the region as a whole, with the goal of achieving self-sustained economic development. From a market access perspective this translates into the reduction of tariff and non-tariff trade barriers solely among these nations. Import tariff reductions are presently being phased at a biennial rate of 10 percent until 1996, with a goal of eliminating tariffs entirely by the year 2000. A program has also been put in place to simplify and harmonize Customs procedures and documentation requirements of the member nations. Numerous other measures in support of economic growth have also been launched over the past five years, to ensure that members of the regional business community have access to the technical, financial, and promotional assistance they require to successfully undertake regional trade.[3]

4.66 A key aspect of the implementation of the PTA is the provisions regarding the rules of origin. As originally drafted, the PTA allowed only products produced by firms with at least 51 percent local ownership to qualify for any benefits under the treaty. In May 1986, this requirement was replaced with a sliding scale, as follows:

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

4.67 In addition, the c.i.f. value of the imported materials used in the production of goods exported under the PTA cannot exceed 60 percent and the local value-added component must account for at least 45 percent of the ex-factory cost. Taken together, these rules of origin requirements limit the attractiveness of the PTA program as a stimulus for foreign investment in a Kenyan EPZ. For the most part, EPZ firms' ownership structure and production processes are likely to disqualify them from utilizing the program at a meaningful level. For local manufacturers, however, the benefits offered under the program may provide a significant market advantage, depending on the composition of their production inputs and processes.

---

[3] For example, efforts have been launched in support of regional trade promotion (information dissemination, trade fairs, promotional publications) and a federation of regional chambers of commerce has been established to promote investment. A PTA Clearinghouse was established in 1984, as the first step toward the establishment of a regional monetary union. Its immediate objective is to promote the use of national currencies in the settlement of transactions among member states. However, less than one fifth of PTA trade is currently settled through the Clearinghouse. In 1986, a PTA Development Bank was established to provide financial and technical assistance to businesses in the region. Plans to encourage intra-regional cooperation in the improvement of transport linkages and to expedite cross-border traffic have been defined, but little progress has been made to date.

B. DEMAND ANALYSIS: POTENTIAL INVESTOR RESPONSE TO KENYAN EPZ OPPORTUNITIES

4.68 End-user market trends and preferential trade agreements augur well for EPZ development world-wide in the decade to come. To realistically appraise the opportunity for EPZ success in Kenya, however, a determination must be made of the "fit" of the country's current and pending endowments (including a competitive incentives program) with the locational requirements of targeted EPZ industry sectors.

4.69 This section begins with an overview of investment and sourcing patterns observed in EPZs, with particular emphasis upon the factors governing investor decisions. It then examines the Kenyan EPZ opportunity relative to other EPZ programs to identify high-potential industries for the country. After analyzing the locational requirements of industries in high-potential sectors, the analysis compares these potentials with the actual investment flows observed in Kenya during the 1980s.

1. Global Trends in Offshore Production

a. Production Sharing

4.70 The past four decades have witnessed the fundamental restructuring of the organization and distribution of global production. As the comparative economic advantages of the industrialized countries have shifted, an internationalization of production processes has occurred based on complementarities between factors of production in developed and developing countries. Typically, the segmentable, labor-intensive portions of production processes have moved to lower cost offshore locations, while more highly skilled, capital-intensive operations are conducted in developed countries where skilled labor and technological and scientific resources are plentiful.

4.71 This phenomenon of "co-production" or "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 significantly in the 1960s.

4.72 In an attempt to defend domestic markets against international competition, producers have transferred abroad those production processes in which they have lost their international competitive advantage. Several factors are contributing to this phenomenon:

- wages in developed countries have risen to levels rendering most labor-intensive processes uneconomical;
- international communications and transport costs have fallen;
- new laws enacted by industrialized countries encourage the offshore assembly of locally made components;
- European and U.S. firms are facing increased competition from Asian imports; and,

- offshore facilities costs are generally lower than in traditional production centers.

4.73 In many cases, only certain segments of the production process are relocated. Labor-intensive operations are transferred from high-wage to low-wage areas, while capital-intensive and technology-intensive portions of manufacturing operations remain in place. The most important determining factors for the success of this type of segmented operation include:

- relative costs of labor, transportation, and communications;
- potential for cost-effective segmentation of production processes;
- importance of quality control in production;
- perceived risks associated with the investment;
- relative economic costs and suitability of automation; and
- the preferential access provided to developed country markets.

4.74 All of these factors have combined to influence the direction and composition of international trade in manufactured goods, creating new opportunities for developing countries to attract investment in manufacturing. In 1965, 78 percent of all LDC exports were primary products. By 1986, however, this figure had fallen to 48 percent of total exports. Between 1965 and 1985, the growth rate of LDC manufactured exports averaged 12.2 percent, compared to 4.6 percent for total exports. The industrialization of these countries was stimulated by their comparative advantages as locations for offshore production.

4.75 The initial beneficiaries of the trend towards offshore production have been the Far Eastern NICs. The adoption of extremely favorable export-oriented development policies has led to dramatic economic achievements by the four "Asian Tigers." In the early 1950s, the per capita income of the NICs was generally equal to leading Latin American and African countries. Between 1960 and 1984, the GDP per capita of the Asian NICs increased more than eight-fold in real terms, on average.[6] An indication of the rapid development of the NICs is the fact that they are currently seeking membership into the Organization for Economic Cooperation and Development (OECD), the organization of the world's most industrialized economies.

4.76 The process of redistribution of international production and investment that began in the 1960s is continuing to evolve today. The Asian NICs are themselves losing their highly labor-intensive industries to a new generation of countries that are rapidly becoming major world producers of manufactured goods and services. This movement of firms engaged in various labor-intensive light manufacturing activities away from the "traditional" Far Eastern NICs is due to a number of underlying factors:

---

[6] The economic achievements of the Far Eastern NICs are especially notable when contrasted to the experience of most African countries during the same period. In 1966, total Far East exports of manufactured goods were just double the average African level. By 1984, they were nearly 14 times higher.

- Labor costs are rising rapidly in the Far Eastern NICs. Between 1984-88, the average industrial monthly wage in the four NICs increased in real terms between 32 and 100 percent. Manufacturers in these countries are moving to the production of higher value-added activities at home, while moving labor-intensive production to lower wage countries.

- The Asian NICs have lost their duty-free access to the U.S. market previously available through the U.S. Generalized System of Preferences (GSP) program; South Korea has lost similar access to the EC market through the GSP. This has directly benefitted the other developing countries that are eligible for GSP preferences.

- Most NIC currencies have appreciated significantly against the U.S. dollar, further eroding their export cost competitiveness. Between 1986-88, the NIC currencies appreciated on average in excess of 25 percent relative to the U.S. Dollar, making their exports more expensive in dollar terms.

- Political and economic uncertainty is increasing in some of the NICs. For example, a recent survey of over 50,000 manufacturing enterprises in Hong Kong revealed that over 60 percent were seriously considering moving their production facilities elsewhere.

4.77 As a result, NIC firms are increasingly looking for new production locations in developing countries, a trend that has benefitted certain developing countries offering a comprehensively attractive package of incentives and services. As shown in Table 4-3, direct foreign investment by the NICs has accelerated in select southeast Asian countries. In 1988 alone, the four NICs contributed 31 percent, and Japan 30 percent of the US$11.9 billion worth of projects approved in Thailand, Philippines, Malaysia, and Indonesia. These countries differ widely in geographic location, resource endowment and other characteristics, yet have become leading centers of export manufacturing in a little more than one decade. Major examples include the following:

Thailand has rapidly become the preferred location of Japanese, Taiwanese and Korean firms seeking to reduce production costs. Taiwanese investors alone have invested in excess of US$2.1 billion in export-oriented electronics, apparel, agro-processing, and other activities. Marubeni Corporation, a private Japanese trading company, has developed a completely private Export Processing Zone catering to the specific needs of Japanese companies. Last year, over 200 new companies established operations in the country, creating almost 20,000 jobs, and raising GDP per capita to over US$1,000 per year.

Mauritius has developed into a major center of export manufacturing and services operations. In 1988, over 150 firms from various countries including Hong Kong, France, and India established export processing operations, generating over 15,000 new jobs. Today, Mauritius is the world's third largest producer of knitwear products, and accounts for 25 percent of the U.S. market.

TABLE 4-3
DIRECT NIC INVESTMENT IN THE NEW SOUTHEAST ASIAN NICs, 1988
(US$ millions and percentage change*)

From/To:	Thailand		Philippines		Malaysia		Indonesia	
Japan	3063	217%	95	229%	214	134%	226	-56%
Hong Kong	446	266%	27	-3%	50	350%	232	90%
S. Korea	109	742%	2	100%	9	1013%	209	1249%
Singapore	275	530%	2	166%	66	22%	255	1876%
Taiwan	850	184%	109	1109%	147	212%	923	11584%
Total ** **Asia:**	**5019**	**221%**	**253**	**222%**	**508**	**134%**	**1845**	**175%**
Total World:	**6225**	**220%**	**452**	**171%**	**768**	**158%**	**4426**	**267%**

* Percentage figures represent the change in direct investment inflows over the previous year.

** Figures do not add owing to inclusion of investment by other Asian countries.

Source: Data compiled from various sources by TSG

Dominican Republic in the Caribbean Basin has attracted investment in export-oriented manufacturing and informatics operations from U.S., European, and Far East companies. Through its highly successful EPZ program the Dominican Republic enjoys annual exports of manufactured goods and services to the United States of over US$600 million.

4.78 In addition, competition for global investment is increasing among a large number of other developing countries who are becoming increasingly sophisticated in their export and investment promotion strategies and policies. Caribbean Basin countries such as Costa Rica and Jamaica have set up investment promotion units in Taiwan and Hong Kong to attract investment. India has deregulated its economic policies within its high technology zones to facilitate U.S. investment in export-oriented software development services. A private Export Processing Zone law to attract foreign investment has been passed recently in the West African country of Togo; the development of a similar regime is now underway in Cameroon and Kenya. Australia, Canada, and Belize are examples of three countries which have offered accelerated citizenship programs to Hong Kong investors who are willing to invest a minimum amount in productive enterprises. As these examples indicate, the structure of international production and investment is continuing to evolve.

4.79 For many developing countries, however, the goal of export-led industrialization has remained elusive. Much of the increase in manufactured

exports cited above has been generated by a small segment of the more advanced developing countries, particularly the NICs in the Far East. Their successes, and to a large extent their rising wage levels, have in turn stimulated the geographic dispersion of manufacturing to other developing countries. Producers in the NICs themselves have also sought to expand in new countries with favorable cost structures and market access. This has led to outward investment in countries such as Malaysia, Thailand, and Mexico, as well as countries in the Caribbean and Central America.

4.80 In summary, a broad spectrum of industrial and service activities are now being productively undertaken in developing country locations worldwide. Opportunities will continue to emerge, and the changing nature of global production and service activities creates attractive possibilities for new entrants. With the notable exception of Mauritius, the African region has barely begun to develop non-traditional export industry and services, and to realize its potential as a new offshore base serving the European and U.S. markets.

2. Locational Requirements of Target Industry Sectors for Kenya

4.81 Kenya is well-positioned to attract European and U.S. investment in many labor-intensive export operations. Unburdened wage levels at present are roughly one fifteenth of U.S. levels, for example, and one twentieth of those of West Germany in the apparel sector. Kenya's wages are also attractive relative to leading offshore locations in the Caribbean and Latin America, the Far East, North and West Africa, and the Mediterranean. Moreover, the range of international preferential trade agreements to which Kenya is a signatory, coupled with its virtual freedom from quota restrictions on its manufactured exports to developed country markets make it well-positioned in this regard as well.

4.82 Kenya's geographic location makes it well suited for regional export activity, and transportation linkages with Europe are well-established for both sea and air, factors important for all sectors examined. Kenya's resource endowment also favors the development of agro-processing operations for export. Likewise the comparatively well-developed infrastructure, established business service sector, coupled with the overall quality of life for expatriate workers, are all positive indicators for attracting investment in each of the sectors examined. In other respects, as discussed in Chapter 3, Kenya is at a disadvantage relative to global competitors. The existing regulatory and legal structure applied to export industry and foreign investment is lacking in key areas and incentive schemes are poorly implemented. This is an area where the establishment of a competitive EPZ regime can, of course, have a profound positive impact.

4.83 On a sector-specific level, the primary markets for a Kenyan EPZ, in its initial stages are most likely to be found in apparel and footwear assembly and other light manufacturing. To a lesser extent, agro-processing firms may also be attracted to Kenya, perhaps within the framework of a "special" or plant-specific EPZ, at a location of their choosing. At present, it is less likely that the electronics sector will be a primary initial market for investment in an EPZ, given the more sophisticated locational requirements of the industry.

As has been demonstrated in other EPZ locations around the world, electronics activity is generally established after a solid base has been developed in the traditional sectors, such as apparel, and in those locations offering a high standard of facility (air conditioned plant, customized building specifications, etc.).

4.84 Taken as a whole, the growing markets for apparel, footwear, and processed agricultural products can provide a solid foundation for the development of a Kenyan EPZ Program, with electronics assembly following in the medium-term. Key characteristics of these sectors are presented below and the potential for their successful establishment in a Kenyan EPZ is assessed.

a. Apparel Manufacturing and Assembly

(i) Global Trends in Apparel Production

4.85 Apparel manufacturing and assembly have experienced slower rates of technological infusion than other internationally diffused industries such as electronics manufacturing. Many of the significant changes in technology have occurred only recently, and primarily in high-end industry sectors of the United States, Japan, and other industrialized countries.

4.86 The principal gains in technology have affected sewing machine speed and accuracy, and control and management of pre-assembly activities (electronic marking and cutting, for instance). Yet, such advances have had a minimal impact on reducing overall production costs; industry analyses indicate that approximately 85 percent of the typical apparel worker's time is spent handling garment components, rather than actually sewing. Given that labor accounts for an average of 35 percent of an apparel product's value, heightened labor productivity is still the key to increased profitability, especially in high-wage countries.

4.87 While the importance of labor costs to competitiveness in the apparel sector has remained constant, production strategies in the industry are changing. Twenty years ago, Hong Kong, Taiwan, South Korea, and Japan dominated apparel exports. Today, production of apparel is globally disseminated, and the production strategies of established apparel manufacturers have been adapted to reflect the industry's growing mobility. The increasing number of producers establishing offshore apparel facilities results from several economic and technical factors. The movement has been encouraged by the advent of manufacturing techniques which have permitted separation of the production process in time and location without affecting end-product quality. On the other hand, manufacturing and assembly by offshore producers is a natural outgrowth of the dramatic increase in the unit cost of developed country labor, materials, and overhead, thereby reducing the competitiveness of facilities in these locations.

4.88 In general, apparel products best suited for offshore production share the following characteristics: high labor content-to-weight ratio; simple design; low line diversity; smaller production runs; low brand name identification; decentralized cutting and parts preparation; minimal capital investment

requirements; stable production parameters; and infrequent in-season reorders. The most important factor, arguably, is the labor cost-to-weight ratio. If a product's labor content is relatively high, and its shipping weight relatively low, that ratio will generally favor offshore production regardless of other factors. As a rule, a product with a high labor component can be made in an offshore location at a cost savings high enough to more than offset lower transportation costs or higher productivity in developed country markets paying higher wages.

(ii) Locational Requirements

4.89 Apparel manufacturers establish offshore supply and manufacturing facilities for two basic reasons: to take advantage of low-cost labor and thus remain competitive; and to secure access to developed country markets and escape quota restrictions. Any EPZ that can satisfy these two requirements is in an excellent position to draw investment from U.S., European, and Far Eastern apparel companies, regardless of its relative resource endowment in other areas.

4.90 Garment manufacturing can easily be established in most low-wage locations and the facilities requirements are minimal. Although some firms will pay a premium to be assured of responsive property management, the typical apparel company faces strong competitive pressures to keep fixed costs to a minimum. For the most part, standard factory buildings; an abundant, competitive labor pool; reliable, affordable ocean cargo service; and market access are all an exporter needs to establish successful operations.

4.91 Wages are the most important cost consideration for the industry. Apparel manufacturing is extremely sensitive to labor costs, and apparel products are highly price sensitive at the wholesale level. In addition, the labor force should be easily trainable and able to adapt to alterations in the production process arising from changes in the often volatile consumer market. Apparel manufacturers generally prefer to locate plants close to urban centers with an abundant female workforce and the availability of competent mid-level managers and supervisors is also important. For more remote locations, adequate transportation for multi-shift production is critical.

4.92 In general, the utilities and service requirements of the industry are basic. Reliable power transmission is important and any shortcomings in the electricity supply must be supported through back-up generators. Good telecommunications service is also important to certain types of apparel manufacture, especially for firms specializing in short production runs. Most garments are shipped by sea, and the cost and reliability of ocean freight services, and access to the port, are key concerns for the industry. For the few items shipped by air -- principally more expensive, fashion-sensitive items -- reliable air service is crucial.

b. Electronics

(i) Global Trends in Electronics Production

4.93 Large-scale assembly and manufacture of electronics products and components outside North America and Europe began in Japan in the early 1960s. Low labor costs and the skillfulness of Japanese workers attracted industry leaders, as developed country wages rose during the post-war economic boom. While Japan's electronic component and light assembly production flourished, other Far Eastern countries, led by Taiwan and South Korea, followed suit and the production of standardized electronic components worldwide was soon dominated by companies based in the Far East.

4.94 The success in the offshore manufacture of electronic components and consumer electronics rests largely on the ability to separate various stages of production, especially labor-intensive processes, as well as the standardization of components and production technologies. This allows manufacturers to seek low-cost locations for production of components and low-end consumer products, either through direct investment in offshore locations or sub-contracting to a foreign component manufacturer.

4.95 The importance of lower production costs differs between product categories. Traditional components and products, such as those used in the manufacture of consumer electronics, are normally characterized by strong price competition and standardized technology. Accordingly, low manufacturing costs are essential to remain competitive. Products with a high degree of innovation and specialization are more price elastic with respect to demand, and are marketed based on their quality, technology, and performance.

4.96 Experience indicates that the electronic products most prone to offshore production are those with: 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. The electronics products meeting these criteria contain components such as resistors, capacitors, and include simple finished products such as watches, radios, and television sets.

(ii) Locational Requirements

4.97 The facility and resource needs for the production of electronic components and products are more sophisticated than those of apparel and other light manufacturing industries. Consequently, greater attention must be paid to the physical structure and capital investment requirements. Generally, the parent company or contracting firm will supervise the supply of physical plant and equipment to their overseas production site.

4.98 Electronics assembly plants and low-end manufacturing facilities can usually be accommodated in standard factory shells adapted to meet tenant specifications. Many medium-end products (certain capacitors, semiconductors, and upscale electronics products) require sterile work areas and a highly controlled environment, and are usually not located in LDC regions. Processes involving testing and assembly often require climate-control, such as air

filtration and air conditioning. Singapore and Malaysia, especially, have attracted foreign electronics manufacturers requiring specialized production environments by investing heavily in enhanced facilities and sophisticated industrial parks.

4.99 Within the industry, the location of the plant in terms of access to transportation, services, and semi-skilled labor carries significant weight in site selection. Because of the high value-to-weight ratio of electronic components and products they are often shipped by air and proximity to an international airport with frequent, affordable cargo service is an important consideration. Other basic service requirements include affordable and reliable telecommunications services, with minimal delays for new connections, and an adequate, dependable electrical power supply. Many types of electronics manufacturing require controlled environments, and air-conditioning is often a necessity in tropical climates. If the public power supply is plagued by voltage fluctuations and interruptions in service, back-up generators must be installed.

4.100 To compete in today's market, electronics firms require access to an easily trainable, literate workforce. English-speaking managers and trained technicians are an asset for an offshore location, although expatriates are generally utilized initially.

c. Fruit and Vegetable Processing

(i) Global Trends In Fruit and Vegetable Processing

4.101 The successful development of processing activity provides an effective means to capture increased value-added from the natural resource endowment of a production location, and to expand markets for local agricultural goods.

4.102 In the past, processed food production was dominated by a few industry giants, primarily the same firms which controlled the fresh food industry. Historically, the difficulties inherent in food preservation necessitated the production and consumption of agro-products within the same geographic region. Consequently, in commercial agricultural production, markets were defined by local geographic conditions and transportation networks. With the advent of low-cost refrigeration and increasingly sophisticated food processing and handling techniques, locations possessing comparative advantages in the production of certain food products are now actively exporting both semi-processed foods and finished products. This has accompanied a trend towards increased product specialization, resulting in heightened productivity, lower production costs, and a concomitant increase in the volume of processed agricultural goods traded worldwide. Fresh products which are expensive and difficult to transport have been transformed or "processed" into export commodities.

4.103 Multinational firms are increasingly concentrating on final processing, marketing, and distribution of bulk foods products and rely on brokers and distributors (rather than their own croplands) for their supply of raw and semi-processed goods. These products often originate from small- and medium-sized commercial farms where preliminary on-site transformation is undertaken to bring

bulk quantities of the product to a transportable (semi-processed) state. The bulk goods are then broken down or blended with other inputs, processed further and packaged in smaller containers in locations near the end-market -- grocery stores, restaurants, etc.

4.104 The evolution of the production and distribution process has taken place alongside certain changes in the demand for food products in expanding developed country markets. In the United States, Western Europe, Japan and the Far East, rising incomes have enhanced consumer purchasing power. Advances in communications and increased individual mobility have exposed the consumer to a broader range of food choices. As a result, there has been a substantial increase in the variety of products marketed internationally and the demand for new products is on the rise. Tropical produce, exotic spices, sauces and jellies, and ethnic specialty foods are now widely available in stores and restaurants.

(ii) Locational Requirements

4.105 In general, proximity to, and coordination with sources of production is essential to successful agro-processing operations. This can be viewed from two perspectives. For locally produced agricultural products, the processing operations should be linked to the harvests of the domestic suppliers. For larger scale, regional agricultural transshipment and processing facilities, production requirements and economies of scale necessitate a reliable, steady supply of the raw materials and semi-processed goods to be utilized in the processing operation.

4.106 As a rule, refrigerated warehouses should be included in the project master plan as a standard facility available to firms within the industry. For some simple packaging businesses, standard factory buildings will suffice for their operations. For those firms utilizing advanced technology, however, often the best strategy is for the firm to construct facilities at its own expense, within pre-determined structural guidelines, as the specialized buildings may be of little use to any other firm. Many companies prefer locations outside of designated general purpose free zones to realize the benefits of locating their operations close to the source of their raw materials.

4.107 Access to an abundant labor supply is less crucial than for other types of free zone industries. For most basic processing activities, manpower skill requirements are minimal and can be satisfied by unskilled labor, although the growing sophistication of the processes and equipment involved in state-of-the-art technologies, gives an advantage to those locations which can supply skilled managers, technicians, and agricultural specialists.

4.108 Reliable and affordable power is essential for agro-processing. Local power supply should be augmented by back-up generators if necessary to ensure a constant supply. Many processing operations also require large amounts of water for industrial use and special waste-water treatment. Management should determine the special needs of individual users prior to leasing or constructing facilities to ensure that the demand their operations will place on the system will not overload its capacity.

4.109 As in other sectors, good telephone and telex service is important to firms engaged in international agricultural processing and distribution activities. Long delays in installation, intermittent service and problems in overseas dialing can deter investment and frustrate clients who are arranging sales and require frequent contact with suppliers, brokers, and distributors.

4.110 Reliable inland transportation services and infrastructure are crucial. In this industry, much more so than in other sectors, it is imperative that there be regularly scheduled and rapidly delivered shipments of the unprocessed goods to the processing facility. Refrigerated trucking, warehousing and shipping services between the source of the goods and the production center is essential. Once the goods are processed, transport time becomes less crucial; however, easy access to a frequently serviced port facility is a must.

4.111 Agricultural training and research centers can serve as attractions for agro-processing businesses. In order to remain competitive with large-scale developed country producers, firms must look toward improved crop yields, which translates to increased technical skills for their production specialists. In this manner, not only will the overall quality of the product improve (thus facilitating entry to the tightly regulated U.S. and EC markets) but the workforce will benefit from increased linkages between the schools, the fields and the industrial workplace.

d. Leather Footwear Processing

4.112 Several large sub-sectors -- including leather, synthetics, rubber and textile -- comprise the footwear industry. This analysis concentrates on leather shoes in the context of total footwear products. The non-rubber footwear industry includes outdoor footwear (most dress and sport shoes), indoor footwear (slippers), orthopedic shoes, and specialty shoes such as competition athletic and military shoes. Production data for footwear are generally presented in volume, or pairs. However, when applicable, value data are presented as well.

i. Global Trends in Footwear Production

4.113 Total global production of all footwear reached 9.7 billion pairs in 1987, growing 3.6 percent over 1986 levels. The Asian and Middle Eastern region accounted for 50.7 percent of the total production, while Eastern and Western Europe produced 18.1 and 12.5 percent of the total volume of production, respectively. South America and North America produced less than 10 percent each. The largest five producers in terms of volume in 1987 were China, USSR, Taiwan, Brazil, and South Korea.

4.114 Leather footwear products represent approximately 32 percent of the total footwear market in volume terms. Global production reached an estimated 3.1 billion pairs in 1987. The principal exporters of leather footwear are located in East Asia and Europe, with Italy substantially ahead of South Korea and Taiwan in terms of export volume. The majority of exports from European countries are destined for other European countries, while exports from East Asia are absorbed

by Western Europe and North America principally. Brazil has proven to be a dominant leather footwear exporter within Latin America, with 70 percent of production in volume terms oriented toward the U.S. market.

4.115 Footwear industries within North America and Western Europe are undergoing severe cost competition from East Asian producers, traditionally South Korea and Taiwan, and more recently China, India, Thailand, Indonesia, and the Philippines. In general, producers in high-labor cost countries have had to chose among three broad strategies to reduce costs and remain competitive: reorient manufacturing toward automation and the increased use of capital-intensive processes; relocate operations domestically to lowest-cost locations and/or utilize immigrant labor; or relocate operations offshore in a low-labor cost country.

4.116 Automation, according to manufacturers, is both costly and risky in today's footwear manufacturing environment. The increasingly volatile tastes of consumers, combined with the general inflexibility of machinery to various degrees, has resulted in higher costs over the medium to long term for firms introducing highly capital-intensive processes to their operations. On the other hand, relocation of facilities within industrialized borders has met with some success, as evidenced by the relocation of many U.S. footwear manufacturing facilities to the southeast and southwest regions of the country over the past 25 years, as well as recent movement of Western European firms, particularly in the EC, to the low-cost countries of Spain, Portugal, and Greece. By far the most evident trend within the footwear industry, however, is the increased use among industrialized producers of offshore production arrangements such as subcontracting, shelter programs, and direct investment in captive facilities.

4.117 The development of the East Asian footwear industry was, to a large degree, a result of early relationships between Asian firms and industrialized-country manufacturers, particularly those in the United States. Substantial labor savings, combined with gains in production quality and reliability, led to tremendous expansion within countries such as South Korea and Taiwan during the 1960s and 1970s. As domestic capacity increased, labor costs rose over time (particularly during the late 1970s and early 1980s), reducing the large gaps in price competition and forcing a portion of both newly industrialized and industrialized country producers to, in turn, reduce costs through the utilization of alternative offshore production sites.

4.118 This trend has been evidenced by the large numbers of South Korean firms investing in facilities in the developing countries of Asia and elsewhere, prompting the Government of Korea to temporarily suspend all external investments by Korean footwear firms. Spurred by foreign investment, export production of footwear, especially leather shoes, in developing economies has recorded strong rates of growth in recent years. Countries in Asia and Latin America -- including China, India, Thailand, Indonesia, the Philippines, Brazil, Tunisia, Mexico, the Dominican Republic, and Haiti -- have developed a domestic industrial base in the leather footwear sector, despite insufficient domestic supplies of hides and leather in many cases. For example, one recent entrant into the international footwear industry, the Dominican Republic, has witnessed growth in exports reach 300 percent per annum over the past three years. While South Korea and Taiwan continue to provide established, reliable manufacturing

environments, other emerging producers such as Thailand and Indonesia possess large, productive labor forces at competitive rates.

4.119 Countries with abundant supplies of hides and semi-finished and finished leather show potential as offshore processing locations. Brazil, India, and China are more established producers; however, the quality of hides and leather has in many cases been a prohibitive factor for many investments. Instead, some manufacturers have chosen to continue to source leather from industrialized countries such as the United States, while utilizing the offshore facility for manufacturing of the shoe product alone. As consumer demands within North America and Western Europe regarding quality and durability mount, leather abundant entrants into the international footwear market must strive to improve the qualitative characteristics of domestic hides and leather.

ii. Locational Requirements

4.120 Leather footwear manufacturers, in the same general manner as other light manufacturing firms, investigate offshore locations for production to decrease costs by utilizing low-cost labor and thus remain competitive, as well as obtain access to industrialized-country markets. The leather footwear industry does possess several characteristics, however, relating to locational requirements.

4.121 The needs of the footwear firms with regard to labor are similar in nature to the needs of general light manufacturing operations employing simple, unsophisticated processes such as in the offshore apparel industry. Footwear manufacturing can generally be established in most low-wage locations, given the quality requirements of the product under consideration, and the facilities requirements are relatively standard. Access to standard factory buildings, a semi-skilled, reliable labor force, affordable ocean cargo service and air freight, and market access are the principal components needed for establishing an offshore venture.

4.122 Although wages are critical in drawing initial interest in an offshore location, the quality of the labor force -- in terms of trainability, reliability, responsiveness, and productivity -- is becoming essential for many leather footwear firms. Increasing consumer demand for high quality, lasting footwear products has forced manufacturers to place a premium on producing shoes that provide acceptable fit and finish, as well as durability. While the apparel industry is sensitive to labor costs, footwear firms are becoming increasingly sensitive to established relationships with subcontractors and workers in low-labor cost countries. In general, footwear firms do not seek an offshore location for absolute cost reduction in direct labor costs, but rather seek to strike a balance between wage bill reductions and sustained product quality and production consistency. As in all light manufacturing industries, the availability of competent mid-level managers and supervisors can greatly ease costs associated with administration and management.

4.123 Footwear manufacturers can be accommodated in standard factory shells, generally preferring single-story structures of 1,400-2,800 sq.m. (15,000-30,000 sq.ft.), with 4.6-6.0 meters (15-20 feet) of clear height. Buildings should ideally be designed to have approximately 14 sq.m. (150 sq.ft.) of under-roof

space per worker, as machinery associated with footwear assembly requires larger areas of dedicated floorspace than the apparel industry.

4.124 Footwear products and components are shipped by both sea and air freight. The turn-around capability of offshore footwear production has become a highly scrutinized factor, and frequent and reliable freight services at a reasonable cost are of critical importance. Customs services at points of entry/exit should be efficient and straightforward, allowing exporters to effectively predict and comply with all laws and regulations of the host country. In addition, adequate telecommunications service can serve to increase the attractiveness of a location, particularly as firms within the industry increasingly utilize telecommunications channels to transmit designs and other technical and operational data. In addition, consistent electrical supply is required to ensure that labor savings are not offset by down-time due to power fluctuations or outages.

3. Recent Investment Trends in Kenya

4.125 Relative to other countries in the region, Kenya has been supportive of private sector involvement in the economy since independence. The government's economic development policy has recognized the important role that foreign and domestic private investment can play in national efforts to strengthen and deepen the economy. Review of recent annual budget speeches, the 1989-93 Development Plan, and other GOK documents outlining the nation's economic strategy reveal a common thread of support for the role of the private sector.

4.126 In practice, however, the implementation of GOK policy has been slow and problematic. Bureaucratic and regulatory constraints in the form of complicated and time-consuming import licensing procedures, restricted access to foreign exchange, and loosely defined investment approval criteria have taken a toll on private investment in general, and foreign investment in particular. While statistics show that private sector investment in Kenya has increased from 10.7 to 12.5 percent of GDP between 1984-85, a substantial portion of this investment can be attributed to parastatal corporations.

4.127 As of mid-1988, approximately 180 multinational corporations -- mainly from Britain, the United States, and West Germany -- had an estimated US$1billion in local assets. Nonetheless, despite a generally positive attitude towards foreign investment during the past decade, the Kenyan Government has witnessed a dramatic decrease in nominal inflows of foreign capital into the economy, far below previous levels achieved during the previous decade. In 1979, according to the International Financial Statistics of the IMF (see Table 4-4), direct foreign investment reached US$78 million. By 1983, the annual level of new direct foreign investment had slipped to US$3 million, less than four percent of the 1979 level.

4.128 Foreign investments rebounded in 1987, with nominal annual direct commitments reaching US$37 million in 1987. However, despite the gains during 1986 and 1987, investments plummeted again in 1988, signaling a strong lack of confidence in the Kenyan investment climate on the part of foreigners. During 1987 and 1988, a reported 100 U.S. firms represented in Kenya have either

TABLE 4-4
FOREIGN DIRECT INVESTMENT IN KENYA, 1977-88
(US$ Millions)

YEAR	US$MILLIONS
1979	78
1980	78
1981	8
1982	3
1983	9
1984	4
1985	13
1986	27
1987	37
1988	7

Source: IMF, International Financial Statistics, October 1989, p. 320

withdrawn or sold their subsidiaries to local investors. Other reports do note, however, that foreign investment is oriented increasingly toward joint ventures. Informal statistics estimate that over half of the multinationals present in Kenya possessing some controlling interest in joint firms.

C. IMPLICATIONS OF GLOBAL TRENDS AND MARKET ASSESSMENT FOR KENYAN EPZ DEVELOPMENT STRATEGY

4.129 The preceding discussion has raised numerous issues regarding the market and demand for EPZ facilities in Kenya that have implications for the configuration and implementation of the EPZ regime. Each industry sector has special key requirements and firms seeking to locate in an EPZ compare potential EPZ sites to see if these requirements are met. The principal implications for Kenyan EPZ strategy development are summarized below.[1]

4.130 Based upon the research and analysis conducted, preliminary conclusions can be drawn regarding the likely sectoral and geographic origin of the demand for space in a Kenyan EPZ. Initial interest in a Kenyan EPZ is most likely to come from firms, both domestic and foreign, already located in Kenya. Locally based firms are well-versed in the attributes, advantages and constraints, of a Kenyan location and are already running at least moderately successful businesses. For many of these firms, therefore, the establishment of an EPZ regime represents an attractive opportunity to both increase the profitability

[1] The needs of light manufacturing industries in terms of specific facilities and services are discussed in further detail in Chapter 7.

of their existing operations and to access new markets or expand their production.

4.131 In general, foreign firms with little familiarity with a particular offshore location -- such as Kenya, or more broadly, the African region -- are likely to be cautious about an EPZ program that is still in the planning stages or even in the initial period of operation. Often, foreign firms will wait to observe whether a program has been successful in attracting locally established businesses (again, either domestic or foreign, but particularly foreign); if the EPZ has developed a solid basis of such investment, this success will be helpful in marketing efforts directed toward foreign investors.[8]

4.132 For these reasons, while a Kenyan EPZ is still in the initial stages of development, the primary investment in the EPZ is likely to originate from firms already established in Kenya. However, the trends in offshore investment identified in the preceding sectoral analyses offer the likelihood that there is substantial potential for offshore investment interest in a Kenyan EPZ. A Kenyan EPZ program is likely to meet with success in attracting EC and perhaps U.S. foreign apparel firms seeking offshore sourcing arrangements in low-wage locations or subcontracting relationships with local businesses. The above analysis of offshore trends indicates that the types of foreign firms most likely to invest in a Kenyan EPZ in the near-term are found in the apparel and the leather footwear sectors. In the longer-term, investment by electronics firms is possible, and Kenya's extremely favorable agricultural resources make it competitive investment site for agro-processing firms seeking offshore locations. As shown by the development patterns of other EPZs around the world, however, key sources of foreign investment in a Kenyan EPZ are most likely to be from apparel, footwear and other light manufacturing sectors.

4.133 One of the chief forces driving foreign investment offshore -- in addition to the need for low-cost labor -- is the search for access to developed country markets. The possibility also exists, therefore, for direct foreign investment from Far Eastern firms seeking duty-free access to European U.S. markets. Far Eastern firms have encountered highly restrictive quotas for their direct exports to many developed country markets. Thus, many Asian firms are seeking footholds in offshore locations which still have such access. Asian firms have been leading investors in Mauritian free zones and are becoming increasingly important in free zones in the Caribbean and Central America. As wage rates in Mauritius continue to rise and the work force approaches full employment, the EPZ apparel industry is undergoing changes that may work in Kenya's favor. Moreover, as seen in Chapter 3, Kenya's basic factors of production are comparably favorable to other leading EPZ programs. Finally, for Asian, U.S., and EC investors alike, Kenya's English-speaking labor force gives the EPZ program a comparative advantage over alternative locations in the countries of Latin America and West Africa.

4.134 In summary, near-term demand for Kenyan EPZs is likely to rest heavily on local businesses. However, in order to solidify local demand and to ensure that foreign investment is attracted to a Kenyan EPZ, much will depend on the

---

[8] This subject is explored further in Annex B.

competitiveness of the policy package that is set forth in the EPZ legal and regulatory framework. The key elements of this framework are presented in the following chapter.

V. PROPOSED LEGAL AND REGULATORY FRAMEWORK

A. OVERVIEW

5.01 The careful formulation of the regulatory framework which governs and facilitates EPZ development is the foundation of any successful EPZ program. Well-drafted legislation encompasses not only the incentives and other benefits offered to EPZ users, but contains explicit provisions to ensure that they are effectively implemented. It reflects a careful knowledge of the legal configuration and content of competing EPZ regimes and also a realistic understanding of what is desirable and feasible within the existing economic and institutional environment.

5.02 The purpose of this chapter is to define all aspects of a successfully functioning export processing zone regime in Kenya. The optimal EPZ legal and regulatory framework for Kenya should incorporate three sets of factors:

- the package of incentives and services offered should draw upon the record of successful EPZs worldwide, and must be competitive with these zones;
- reflect the needs of the multinational company and local investor in terms of incentives, services and amenities; and
- offset the cost and other constraints of operating in Kenya, and build upon the country's comparative advantages.

5.03 The following discussion builds the case for the key elements of proposed Kenyan EPZ legislation based upon a consideration of the three factors listed above. The implementation aspects of the recommended regime are discussed in Chapter 6.

B. PROPOSED ELEMENTS OF THE KENYAN EPZ LEGISLATION

1. Basic Principles

5.04 The EPZ regime consist of a set of regulatory measures designed to encourage export industry, principally import-dependent export manufacturing. These measures are intended to remove existing disincentives to export manufacturing to allow industry to be competitive in global markets and capitalize on the inherent comparative advantages of the location. Unlike partial export regimes such as manufacturing-under-bond and duty drawback which are often elaborate and difficult to administer, EPZ incentives can be conferred on a "blanket basis" to all qualifying export manufacturing and services firms. The cornerstone of the EPZ is the transparency and comprehensiveness of the incentives and the automaticity of their application, without the need for elaborate qualifying criteria. EPZs excel in the two critical elements determining the success of export regimes: the substantive nature of the incentives, and the streamlined procedures for granting access to them. The suggested package of incentives and benefits for the Kenya EPZ regime are enumerated below; implementation measures are the subject of the next chapter.

2. Eligibility for EPZ Status

5.05 **Recommendation: Export processing zone status should be made available to all exporting firms, regardless of their location.** There are a number of advantages to allowing broad access to the Kenyan EPZ program, allowing individual factories to operate as "special EPZs", and not restricting the EPZ status solely to geographically limited industrial parks.

- Such a limitation would penalize existing Kenyan manufacturers with substantial excess industrial capacity who are willing to re-orient production wholly for the export market and cannot be relocate to an industrial park-style EPZ.

- Geographically limited zones would also discourage a number of resource-based operations such as agro-processing, where plants need to be established close to source of the raw materials.

5.06 For these reasons, most successful EPZ programs worldwide offer investors both options: to locate within an EPZ industrial park, or to locate outside the industrial parks and enjoy EPZ benefits. Most of these programs also allow already existing individual manufacturers with excess unutilized capacity to qualify for EPZ status. By providing this flexibility, successful EPZ programs in the Caribbean Basin and the Far East have been able to cater to a range of investors with different locational requirements.

5.07 The primary disadvantage of decentralized, country-wide EPZ activity is that it places a substantial strain on the country's economic infrastructure and administrative abilities to regulate the regime. Given that Kenya is only beginning on the course of EPZ development, it is recommended that the initial focus be place upon industrial-park style EPZs. However, the EPZ legislation should allow for possibility of firms to locate outside the geographical enclave-style EPZs -- and still enjoy EPZ benefits. Such designations should be made only on a case-by-case basis, based upon a careful consideration of the firm's location requirements, such as proximity to raw materials and other factors.

5.08 **Recommendation: Export processing zone status should be offered only to those manufacturers and service providers that are producing mostly for the export market.** As in the case of most EPZs worldwide, the main qualifying criteria for a company wishing to receive export processing zone status in Kenya should be that its production destined mostly for export. The export processing zone program is designed to attract firms that will use Kenya as an export production platform; zone incentives are not extended to firms which export only a small portion of their output. Policy measures now in place, such as the Export Compensation scheme already include provisions to assist partially exporting firms. Moreover, local businesses with an interest in exporting will always have the option of forming a separate affiliate to produce for export under the export processing zone regime.

5.09 While the Kenyan EPZs should be oriented to predominantly export-oriented manufacturing, the ability to sell up to 20 percent of annual production -- subject to all normally applicable duties and taxes for imports -- to the local market should be allowed (as is discussed in detail in para 5.34 below). Such

an approach has become an integral part of most successful EPZs worldwide for two basic reasons:

- it provides flexibility to the EPZ manufacturer by allowing him to rationalize his production by selling locally seconds, off-cuts, rejects, and a portion of inventory backlogs, rather than the cumbersome and extremely expensive procedure of destroying them under Customs supervision under current MUB regulations in Kenya.

- the experience of other zones has very clearly demonstrated that the more restrictive the provisions for local market access by EPZ products, the more "leakages" have occurred into the local economy. While this depends on the size of the local market and the prevailing import tariff on the product in question, zones offering at least 10 to 20 percent local sales have generally experienced far lower levels of leakage and pilferage than more restrictive zones. In countries with high rates of import protection and no local market sales by EPZ firms, the potential windfall from smuggling of zone products is very high. In these cases, local market sales act as a "safety valve" which reduces the profitability of smuggling while providing some tariff revenues to the host country.

5.10 Local market access of EPZ products (with payment of full import duties) also makes good economic sense, especially in the case of products that are not currently being manufactured in Kenya and are instead being directly imported from third countries. In this case, Kenya at least benefits from the local value-added resulting from the processing in the zone -- payments for services, labor, and materials -- that is otherwise foregone in direct importation.

5.11 Export service providers should also be beneficiaries of the Kenyan EPZ program. Increasingly, export-oriented services such as engineering and consulting services, financial services, informatics (e.g., software development, data entry services, etc.) are increasingly locating within EPZs. In 1986, Mauritius passed the Export Services Zone (ESZ) Act -- which offers benefits identical to the EPZ Act -- to develop export-oriented service activities. Zones in India, Dominican Republic, and Jamaica all have strong representation of computer and other services operations.

5.12 **Recommendation: Zone infrastructure development groups should have access to the same incentives that are offered to zone industries.** In addition to the exporting firms, it is also recommended that private, mixed, or public enterprises which develop and manage export processing zones benefit from the incentives provided by the EPZ regime. This treatment will help to ensure that the export processing zone facilities and services established are globally competitive in both cost and quality (by allowing for duty-free importation of construction materials and equipment), and will attract private capital to the development and ownership of export processing zones. Such provisions have recently been incorporated into a number of export processing zone regulations where private sector or mixed responsibility for zone development is permitted, such as Turkey, Mauritius, Malaysia, Dominican Republic, Costa Rica, Honduras, and Guatemala. In Mauritius, special incentives for private developers of EPZ factory space had to be passed in 1986, in order to ease the large shortage of

buildings for EPZ users. Typically, the package of benefits for EPZ manufacturing enterprises are "extended" to the developers and operators of the physical facility, who are essentially indirect exporters that are generating foreign exchange.

5.13 Summarizing the above discussion, three types of entities will be eligible for export processing zone status:

- export firms locating within defined industrial park areas operating as export processing zones;
- export firms located outside of such enclaves; and,
- firms developing and operating EPZ infrastructure and physical facilities.

It is useful to distinguish between these categories, as the regulatory practices will vary somewhat, principally with respect to the Customs treatment accorded firms located within and without geographically defined export processing zone enclaves. Likewise, zone development groups are essentially industrial facilities development and management organizations, whether public or private, and will therefore utilize and benefit from zone incentives in a different manner than their production-oriented counterparts. Specific application and approval procedures for export processing zone status for each types of entity are described in the second part of this chapter.

5.14 **Recommendation: Foreign and domestic investors should be treated alike under the export processing zone regime, each offered the same incentives and subject to the same controls.** The principle of equal treatment of foreign and domestic capital has been one of the most important aspects of successful EPZs. In countries like Taiwan, Dominican Republic, and Mauritius, local firms were encouraged to set up EPZ enterprises. As a result of that policy, in Mauritian EPZs some 55 percent of EPZ firms are locally owned. Even South Korea, which for years precluded local participation in EPZ enterprises except in joint ventures, now strongly encourages local participation. EPZ-sponsoring countries in the Caribbean Basin have discovered that EPZs are among the preferred methods of repatriating the "blocked" local currency holdings of locally-based companies; still other evidence points to the fact that EPZs are attracting "flight capital" of local firms. In the initial stages of EPZ development in Kenya, the local manufacturing sector is likely to be a primary source of demand for zone facilities. It is imperative therefore that the Kenya EPZ legislation makes it clear that all investors, all types of investments -- 100 percent foreign ownership, 100 percent Kenyan ownership, and all types of joint ventures and contracting arrangements -- will be equally eligible for the full set of EPZ benefits available under the law. A strong statement by the GOK in this regard is absolutely necessary to offset the widespread fears among local investors, and the strong negative perceptions of foreign firms, about the unintended results of the current "Kenyanization" policy of the GOK.

3. Proposed Incentives for EPZ Enterprises

5.15 As discussed in Chapter 2, the basic incentive package and operating environment offered by EPZs worldwide share many common elements. Individual

countries, however, differ in how their zone programs are implemented and in the degree to which they are integrated with the economy as a whole. The incentive package proposed below has been tailored to reflect the attributes of the Kenyan context. As mentioned earlier, some of these incentives already exist in various forms in Kenya, under the Manufacturing-Under-Bond and Export Compensation schemes. However, many of these incentives are either insufficiently attractive, offer only partial exemption, or are not routinely accessible. Most importantly, they are not grouped together as a set of benefits which can be granted as a defined package, but require separate application and qualification procedures, often to different agencies of the Government.

5.16 One of the principal goals of the export processing zone program, as designed, is to combine all the important incentives and regulatory measures governing export industry into one package. In this manner, the investor must make only a single application to a single institution, as described in Chapter 6. The proposed package of Kenyan EPZ incentives available to qualifying EPZ enterprises are outlined below.

a. Imports/Exports Controls

5.17 **Recommendation: All imports required by export processing zone firms for facilities installation and export production should be completely exempt from tariffs and other restrictions.** The concept of exoneration of tariffs on imports of capital goods, raw materials, and intermediate goods is the cornerstone of any export processing zone: transaction taxes on all imported goods used in the production of exports within an export processing zone are not levied. The principal difference between the export processing zone regime and existing mechanisms for refund (under the Export Compensation scheme) and exemption (under the MUB scheme) of import duties is that the former is founded on the principle that all goods entering the country destined for an approved export processing zone firm will be subject to none of these taxes or duties. There will be no need for posting bonds, paying in advance for later reconciliation against taxes owed, special applications for each shipment, etc. Any partial exemption will not achieve the desired results of making export production competitive and creating a regime which is straightforward and automatic in its administration.

5.18 Unrestricted imports and exports is critical to import-dependent export manufacturing. Because production of EPZs is wholly export-oriented, the need for import and export licensing is obsolete. Imports are financed entirely out or export earnings as the EPZ firms are net foreign exchange earners. Export licensing requirements are also unnecessary, since, unlike the EC regime, duty compensation is not sought. An examination of twenty-five of the leading EPZs worldwide clearly indicates that entry of imports without duty, licenses, and other restrictions is universally offered by all zones. Also without exception, exports are not restricted or taxed in any way. It is possible for EPZs to offer this powerful incentive because the production of EPZ firms is wholly oriented to export markets, and allows the EPZ enterprises to be competitive in world markets. As such, it is recommended that the Kenyan EPZ provide the following benefits:

- duty-free entry of all raw materials, intermediate and finished goods required in the export production process and in the construction of EPZ factory space;
- exemption from all current import licensing requirements and other restrictions;
- duty-free entry of capital equipment and machinery related to the zone activities and construction equipment;
- exemption from all existing export licensing controls that are now applicable to firms operating under the EC and MUB schemes.

5.19 Aside from the benefits to Kenyan EPZ manufacturers in terms of increased competitiveness in world markets, unrestricted importation/exportation has the added benefit of significantly simplifying the role of Customs and the Central Bank in terms of physically controlling and administering the EPZs as discussed in Chapter 6. Any GOK concerns regarding revenue loss from duty and trade tax exemptions are exaggerated for the simple reason that the majority of EPZ activity would not occur in the absence of duty abatement and the other package of incentives. Studies of the EPZs have shown that as much as 70 to 80 percent of investment that has come into EPZs worldwide is incremental -- that is, investment that would not otherwise have occurred. The main impact of duty concessions is ultimately to make the Kenyan economy function more efficiently than it does otherwise. Investors expecting to enter export markets would be at a great disadvantage in their international competitiveness if they were required to pay import duties on imported inputs and equipment, and to compete with other producers in other locations that operate free of duties. Thus, duty exemptions are not "concessions" at all, but rather merely remove existing distortions and taxes, and make Kenya-based producers efficient.

b. Corporate Income Tax Relief

5.20 **Recommendation: Export processing zone firms should be granted an initial corporate income tax holiday of 12 years and have a low flat marginal tax rate of 10 percent thereafter.** Export processing zones typically include partial or total relief from direct taxation on profits for varying periods as part of their incentive package. Some zone locations, which are not otherwise tax havens, offer freedom from profits tax to zone industries in perpetuity (e.g., Jamaica, Barbados, and Honduras). Others impose low nominal tax rates on export processing zone firms, with or without an initial holiday (e.g., Taiwan, Korea, Mauritius, Hong Kong, and Malaysia, ranging from 15 to 35 percent). Most EPZs offer corporate income tax holidays ranging from 5 to 20 years, with an average of 8 to 12 years. (Please refer to comparative charts of EPZ incentives presented in Chapter 2.)

5.21 Regarding the issue of zone tax policy, a number of points are relevant. There is sometimes opposition to the concept of a tax holiday because it is felt that it is needlessly subsidizing large multinationals and plays little role in investor location decision-making. While it is generally true that subsidiaries or affiliates of foreign firms will be using Kenya as a captive export production center operating on a consignment basis -- and therefore not accruing profits in the country -- many other foreign firms located in EPZs internationally are smaller, independent companies operating in very low margin activities such as

garments assembly. For these firms, the relative attractiveness of a tax holiday is a fundamentally important consideration in selecting an offshore EPZ location. This is especially important in the context of local manufacturers in Kenya, who currently operate in an environment that is characterized by significant anti-export bias.

5.22 The length of the tax holiday is of considerable importance. It must not be too short so as to attract only "low-end" industries with the objective of quick profits, thereby penalizing projects with longer gestation periods. Tax holidays allow firms to recover their capital more quickly and maintain greater liquidity in their early years of operation. Consideration should be given to tying the beginning of the EPZ tax holiday to the date at which the EPZ investor first begins to incur the tax liability, rather than on the date of first production as is usually the case. By linking the tax holiday to the date of the first tax liability and providing it for the same period, the tax holiday will be worth the same to all EPZ investors regardless of the gestation period of the project.

5.23 The principal alternative to a tax holiday that is long enough to allow the investor to recover his capital is to have a low flat tax rate on corporate income. While this may seem attractive from the GOK perspective, it is not realistic to expect a relatively unknown investment location such as Kenya to be able to compete with more established EPZs such as Mauritius. The strategy followed in Mauritius and other EPZ locations was to guarantee "pioneering" EPZ firms high profits through the use of a tax holiday, and later substitute a flat nominal tax. The same approach is suggested for Kenya.

5.24 In the final analysis, EPZs are not generally intended to be direct tax revenue-generators for the government: their value is realized in the form of increased employment and foreign exchange earnings, which indirectly bring substantial financial benefits to the economy. Realistically, therefore, since multinationals can easily limit their tax liabilities in any given location, a generous tax policy is not really a "giveaway" of government revenue to any significant extent. EPZ countries which have successfully imposed profits taxes are generally established offshore production centers. New entrants such as Kenya will need to be more competitive. It is important for the Government of Kenya to carefully define the zone tax policy, and this will require reaching a consensus on the relative importance of the issues discussed above. In this light, the following tax incentives are proposed for the Kenyan export processing zone regime:

- an initial corporate income tax holiday of 12 years followed by a 10 percent tax rate each year thereafter; and
- provision for a loss carry-forward provision which will allow firms with longer gestation periods to be competitive.[1]

---

[1] This provision should be more liberal than that available under the Income Tax Act which restricts losses carry forward to taxable profits in the same category of the losses.

A export processing zone regime provides the opportunity to introduce a new and simplified corporate tax system to a specific group of businesses which may later be evaluated for its general applicability. For this reason, the concept of a simple, flat tax at a low marginal rate following a reasonable tax holiday is especially attractive and will benefit both the GOK and the EPZ user.

c. Labor Regulations

5.25 **Recommendation: The principles of existing labor regulations should be adhered to, and access to a defined number of expatriate work permits and streamlined personnel procedures should be made available to each firm.** Labor regulations in export processing zones generally do not differ from those prevailing in the country at large. The few countries which restrict union activity or maintain lower minimum wages in the export processing zones, such as the Philippines, have been criticized for effectively creating two classes of laborers and have created a stigma surrounding the EPZs from the start. Although employed in a EPZ milieu, there is no acceptable rationale for differential treatment of zone workers. Labor is an important domestic factor utilized by export processing zone companies, and should be accessed on the same terms applying to non-zone firms.

5.26 Kenyan labor regulations contain extensive provisions to ensure that workers' rights are respected and that standards governing the terms of employment are observed. Overall, labor regulations in Kenya appear to be straightforward and impartially implemented. There are two areas in the existing labor regulations that may pose problems if rigidly applied to EPZs: the restriction of female employment between 6:30 pm and 6:30 am, and the treatment of expatriate labor. In addition, there are significant potential benefits from liberalizing the process of negotiation of employment between employers and potential employees, as discussed below.

5.27 Light manufacturing assembly operations typical of EPZs commonly need to operate on a high-volume, large-scale basis. Usually, this means that factories operate 24 hours a day on three shifts, including night shifts. Given that some 75 percent of the worldwide EPZ workforce is female, the current restriction on female employment during the night shift is a deterrent to certain types of industrial activities, and should be liberalized.

5.28 Current Kenyan regulations on the hiring of expatriate managerial and technical labor is in the form of two-year permits which can be renewed for another two years. While the visa approval/renewal process for expatriates has been streamlined with the establishment of the Investment Promotion Council, relatively long delays in the process are routinely experienced. Foreign firms routinely expect a more or less automatic system of working visas, to facilitate the early part of a firm's operations. One alternative is to lengthen the current period of the working visa for EPZ firms to more than two years, with automatic renewal for employees of firms with no record of infractions.

5.29 Another alternative would be to include automatic eligibility for expatriate work permits as part of the export processing zone incentive package. Some countries, such as Tunisia, automatically grant a number of work permits

without special application to exporting firms. Such a practice contributes to the attractiveness of the incentive package, and should be considered for Kenya. The number can be defined in absolute terms, that is, a specific number for each firm, or as a ratio relative to the size of the operation, as measured by the total number of employees. In either case, the permit should be automatically available upon qualification as a export processing zone firm. Appropriate numbers would be 12 to 15 expatriate positions per 100 employees. Additional expatriate permits could be made available through the standard application process with the Principal Immigration Officer. In any case, it is imperative that the Kenyan EPZ legislation provide for the guaranteed availability of immigration work permits for key personnel.

5.30 Although the current process of firm-level collective bargaining of employment terms and conditions in Kenya is adequate, the possibility of liberalizing the process for EPZ firms should be considered by the GOK. It is suggested that, subject to existing minimum wage and other labor regulations, all terms and conditions of EPZ employment be freely negotiated between EPZ firms and workers' unions. In case of dispute, arbitration could be provided by Government or by the International Arbitration Association, as is done by many EPZ locations worldwide. It is expected that all other basic provisions of the Labor Code, such as the minimum wage, social insurance contributions, standard leave and vacation policy, etc., would apply to all export processing zone designated companies.

d. Regulation of Foreign Exchange

5.31 **Recommendation: Export processing zone firms and EPZ developers should be provided guaranteed and unrestricted access to and control over their foreign exchange earnings through foreign currency accounts at commercial banks.** Ready access to foreign exchange is one of the most important features of the export processing zone structure. It is essential that freedom from foreign exchange restrictions be codified in the export processing zone regulations. All firms operating under the export processing zone regime will be generating foreign exchange earnings; restrictions on their transactions will not act to conserve foreign exchange but will seriously hamper export business operations which are highly dependent on timely remittances. There are two general approaches taken by EPZs worldwide to ensure the access of EPZ firms to their foreign exchange earnings: through the maintenance of foreign currency accounts at commercial banks, or at a special "window" at the central bank. In both cases the practical effect is the same -- to guarantee automatic access to foreign exchange earnings, although a minimum of bureaucracy and red tape is offered by commercial banks. Although the "green channel" foreign exchange access scheme in Kenya has facilitated access to foreign exchange by exporters, in practice, considerable delays have been experienced as discussed in Chapter 3. As discussed in detail in Chapter 6, it is essential the Kenyan EPZ scheme guarantee unrestricted access to foreign exchange, by allowing EPZ enterprise to maintain their own foreign currency accounts in commercial banks.

e. Repatriation of Capital and Dividends

5.32 **Recommendation: Initial capital invested by zone firms and dividends declared should be untaxed and able to be freely repatriated.** The unrestricted repatriation of profits, dividends, capital and capital gain is a key feature of all leading EPZs worldwide. In the twenty-five countries examined for this report, only three countries impose any restrictions in this area of any kind: India (where free repatriation is allowed only after local tax liabilities have been met); Indonesia (where Central Bank approval is required); and the Philippines (where EPZ firms must wait in line as with all other firms). All of these countries have marginally successful EPZ programs. Dividend income distributed to non-residents in Kenya is currently subject to a 15 percent withholding tax. In addition, the current waiting period for profits/capital repatriation for foreign firms in Kenya is about two years, which is unacceptable from the perspective of EPZ firms which are operating in a quickly changing international economic environment. As such, it is recommended that EPZ firms and developers be exempted from the 15 percent withholding tax.

5.33 As discussed in further detail in Chapter 6, a distinction should be made between foreign EPZ developers and EPZ enterprises who invest foreign exchange in the EPZ, and local investors who are not bringing in foreign-sourced capital. Foreign or Kenyan non-resident firms that invest foreign capital should be allowed to repatriate their profits and capital from their earned foreign exchange after meeting all local currency obligations. Such provisions for local firms are clearly unnecessary as no foreign-sourced capital is involved. In the case of mixed-ownership firms, such privileges should be extended to the extent of foreign ownership.

f. Sales to the Domestic Market

5.34 **Recommendation: Zone firms should be permitted to sell up to 20 percent of annual output to the domestic market, subject to payment of applicable duties, charges and restrictions as imports into the national Customs territory.** There is a strong rationale for allowing sales to the domestic market in certain cases and only as a by product of normal export operations, as discussed in para. 5.08. The majority of EPZ locations internationally offer limited sales to the domestic market -- upon full payment of all duties, taxes, and surcharges that would be normally applicable to identical imports from third countries. In Asian zones, local sales access ranges from 2 to 20 percent of annual production. Three countries -- Pakistan, Hong Kong, and Singapore -- offer unrestricted access by zone products to their local markets. Most zones in Africa/Middle East region are far more liberal in this respect; in the Caribbean Basin region, local sales allowed by EPZ firms range from 20 to 49 percent of annual production.

5.35 The control measures applied to goods imported for use in export processing zone operations require that they all be accounted for; any finished goods which are defective or may not otherwise meet export market standards (odd lots, irregulars, etc.) will need to be either exported or destroyed under Customs supervision, in the few zones that do not allow any access to the local market.

5.36 Normally, export processing zone firms operate under substantially more favorable conditions than local firms producing for the domestic market, and direct competition between the two would be inequitable. To the extent that domestic producers continue to operate in an environment less favorable than that codified in the export processing zone regime, the importation of zone-produced competing goods should be evaluated carefully by the GOK. Where there is no unfavorable impact, the importation may be considered. Steps should be taken to ensure that the firm is principally producing for export; i.e., domestic sales would represent only to a small percentage of annual output. Initially 20 percent is recommended for Kenya. This provision will act as an additional incentive for firms operating in Kenya, while also bringing some benefits to the Kenyan economy in terms of the availability of goods and creation of jobs. It would not, however, be automatic, and would need to be addressed on a case-by-case basis.

g. Relationship of Local Businesses to EPZ Firms

5.37 **Recommendation: All sales by domestic Kenyan businesses to EPZ firms should be treated as exports from the domestic customs territory**. If the primary goal of the GOK in establishing the EPZ program is to stimulate widespread economic growth, one of the most important steps that can be taken in that direction is to facilitate and support the creation of linkages between the EPZ firms and the local economy. This is a difficult task to accomplish, given that traditionally zone users rely on imported raw materials and inputs, primarily because locally available inputs are more expensive and of less quality than those available in the international market. This is the primary reason that in less successful zones worldwide, the average local value-added of EPZ exports is less than 25 percent, in comparison to some 50 to 70 percent in the EPZs of Taiwan and South Korea, where local sourcing by zone industries is standard practice.

5.38 These successful EPZs managed to increase backward economic linkages of their zones by two means. They treated sales of services, intermediate products, and raw materials by local (non-zone) companies to companies within EPZs as exports from the domestic customs territory. They simultaneously established an array of "partial export" promotion measures to reward sales to the EPZs. In Korea and Taiwan, their duty drawback and temporary admission programs are oriented towards rewarding sales to EPZs. In this way, local manufacturers are gradually able to competitively produce goods for EPZ firms to utilize in their production processes. It is strongly recommended that the same strategy be utilized in the Kenyan context by: (a) treating sales by Kenyan (non-zone) companies to EPZ firms as exports (and thus eligible for the Export Compensation scheme); and (b) designing other schemes to reward these "indirect exports" such as income tax rebates linked to the proportion of a local firm's export value-added.

i. Measures to Increase Local Participation in the EPZ Scheme

5.39 A major priority of the Kenyan EPZ legislation should be to maximize the involvement by local entrepreneurs in EPZ development. Among other constraints

to export development (such as lack of market knowledge, dated production technologies, and the like), local firms are deterred from export production due to lack of foreign exchange to initially finance export operations and to develop EPZ infrastructure. It is recommended that the GOK introduce a number of schemes to facilitate private EPZ infrastructure development, provide export financing for EPZ firms and to facilitate technology transfer as detailed below.

5.40 **Recommendation: Establish an Externally Funded Rediscount Line to Facilitate Private EPZ Infrastructure Development.** It is recommended that the GOK establish an externally-funded rediscount line for use by private developers in the development of EPZ factory buildings and other internal infrastructure. Funding could be provided by the World Bank, USAID or other donors for this purpose. The funding could be in the form of an initial loan (at or below U.S. prime rates) to the Central Bank for the establishment of a rediscount line for on-lending by local commercial banks to a private zone developer. The advantages of this approach are numerous. By allowing local financial intermediaries to participate in on-lending to final beneficiaries (either alone or as a syndicate), valuable experience in project term lending can be built. By housing the facility within the Central Bank, an institutional basis can be formed for long-term zone development. Reflows of interest and principal can be rolled over to support further on-lending activities. Properly structured, the rediscount facility could eventually become self-sustaining, while providing an important source of low-cost debt financing for foreign and local EPZ developers.

5.41 The primary disadvantage of this approach is that it is relatively complicated if the Central Bank and commercial banks are inexperienced in term lending based upon project profitability analyses. Commercial banks may be reluctant to disburse funding for zone development ahead of demand for free zone factory space. They may be too conservative in their lending policies by mis-applying short-term credit application review criteria to long-term free zone development projects. These potential handicaps, however, can be overcome through appropriate training and technical assistance as has been demonstrated in other countries.

5.42 **Recommendation: Introduce an EPZ Export Credit Guarantee Scheme.** Unlike firms that only partially produce for the export market, EPZ firms are highly import-dependent and therefore require automatic access to short-term (foreign and local currency) working capital at all stages of the exporting process:

- pre-shipment financing to undertake required feasibility studies, market research, production of samples and required imported inputs to be used in the production process;
- medium-term equipment financing to finance the machinery and other assets required for operations;
- post-shipment credit to cover working capital requirements from the point of shipment to the time of payment.

5.43 Guaranteeing automatic access to export pre-shipment credit at preferential rates is extremely important from the perspective of smaller local manufacturers, who do not have access to foreign exchange. Export finance in the sense of preferential interest rates does not really exist in Kenya. In the present system, an exporter does not receive any financial benefits purely because he

is in the export business. The current cost of foreign currency denominated working capital financing is high in Kenya, and banks have high collateral and security requirements. In most cases, commercial banks will not rediscount a confirmed L/C held by an exporter; they are certainly not willing to accept a firm export order or export contract.

5.44 To offset these constraints, it is recommended that the GOK establish a comprehensive export credit guarantee scheme that will provide EPZ manufacturers with automatic access to working capital at prime interest rates and conditions. Such a scheme would provide blanket GOK guarantees of EPZ export orders, which would allow commercial banks to automatically rediscount confirmed export orders. The GOK should establish some kind of extra-budgetary revolving fund to ensure that the credit guarantees for EPZ exporters are fully backed up, and that commercial banks are fully and speedily compensated in the event of default.[2]

5.45 **Recommendation: Facilitate the Establishment of an Equipment Leasing Company.** A major investment cost for exporting firms is the financing of equipment. Leasing instead of purchasing equipment reduces a firm's medium- to long-term borrowing needs, which in the Kenyan environment is a great advantage. With leasing, the firm rents the equipment or makes payments periodically that at the end of the lease gives the firm ownership. However, during the period of the lease the equipment is owned by the leasing firm. With a lease there is no downpayment, and there is no collateral, since ownership remains with the leasing institution. In short, leasing allows firms to finance equipment from their current cash flow without borrowing.

5.46 The problem is to find the funds to establish a leasing company. The problem is not as great for a leasing firm, because the equipment is salable on international markets. Accordingly, a foreign leasing company could operate in Kenya without great transfer risk, since it could take back its equipment and use it elsewhere or sell it. If leasing were limited to equipment, a leasing firm's local fixed assets would be minimal. Accordingly, foreign leasing firms could be invited to establish operations in Kenya, or they could be invited to establish a joint venture, where they provide training and some financing. The IFC has helped to set up joint-venture leasing operations in almost twenty developing countries, and should be considered an important resource for information and seed capital to establish a leasing company in Kenya.

5.47 **Recommendation: Introduce Measures to Encourage Technical Linkages.** In order to encourage the development of local sourcing and subcontracting arrangements, several measures can be introduced as part of the export processing zone regime. These would include the sale of used equipment being replaced by export processing zone firms to local producers without payment of duty and other taxes, as a way to upgrade the production technology of local firms and to enhance the creation of backward economic linkages.

---

[2] There may be a reason to restrict the EPZ credit guarantee scheme to exports that are going to non-PTA countries, where credit and commercial risks are lower.

j. Other Incentives

5.48 The basic principles of the export processing zone regime proposed for Kenya, as outlined above, make up an attractive and workable regulatory framework, competitive with successful export processing zone programs worldwide, while protecting and promoting the Kenyan national interest. Figure 5-1, the Kenyan EPZ Policy Matrix depicts the core incentives recommended, and the key issues to be addressed by the GOK in the development of a comprehensive package of EPZ incentives. Additionally, a number of other incentives should be incorporated in the Kenyan EPZ regime, including the following:

Exemption from all indirect taxes. The Kenyan tax code imposes a number of other taxes which would have an impact on both export processing zone firms and export processing zone operators, specifically, taxes on real estate, sales (VAT) taxes, and excise taxes. Offering zone firms exemptions from these taxes will make Kenya more competitive from a cost standpoint and, of equal or greater importance, simplify and streamline their compliance and reporting requirements.

Freedom from Price Controls for EPZ Products. It is absolutely essential from the perspective of the foreign and local investor that all EPZ products and companies be exempted from any and all price controls under the Price Control Act.

Exemption from all Licensing and Registration Requirements. EPZ firms should be exempted from all registration and trade licensing requirements available under the Trade Licensing Act.

Easing of Restrictions on Foreign Company Local Borrowings. The current restriction on local borrowings by "non-resident" companies to 20 percent of their original paid-in capital will needlessly penalize EPZ firms, and should be liberalized to allow greater access. Overseas borrowing by EPZ firms should also be facilitated by removing any withholding taxes on interest payments.

Allow Commercial Banks to Participate in an EPZ Banking Scheme. In order to make available long-term financing for infrastructure development, and short-term trade financing, many zones have removed restrictions on commercial banks willing to set up a branch or separate subsidiary to finance EPZ operations exclusively. Such a scheme should be considered by the GOK for implementation in Kenya. Key incentives that could be offered could relate to a liberalization of minimum capitalization requirements and/or special lending requirements -- such as the minimum 15 percent lending to the agriculture sector.

Clarify Laws Concerning Foreign Ownership of Land. Under provisions of the land tenure laws of Kenya, broad powers are given to the GOK to reclaim underutilized land. Specifically, all leasehold improvements made by private parties leasing government land reverts to the GOK upon expiry of the lease without compensation to the party. Also, clarification of GOK

FIGURE 5-1
KENYAN EPZ POLICY MATRIX

Policy Objectives	Key Elements	Issues to be Considered	Lead GOK Institutions
Core Incentives:			
1. Create liberal eligibility criteria for EPZ developers.	- Emphasis on private sector ownership and management. - Automatic "transparent" criteria for eligibility. - Eligibility for all EPZ incentives. - Foreign and domestic applicants treated equally. - Single-user facilities eligible for EPZ designation.	- Existing plants eligible for "special EPZ" status? - Clarify foreign land ownership regulations. - Define contractual framework for leasing/sale of GOK land to private sector, including provisions regarding minimum length of lease and compensation for leasehold improvements.	MOF, IPC, MOC, MOI, Attorney General
2. Create liberal eligibility criteria for EPZ users.	- Equality of treatment for foreign and local firms. - All export-oriented activities eligible. - No preference for joint ventures orKenyanization. - Export-oriented services activities eligible. - Negative list of ineligible activities rather than positive list.	- Should commercial banks be provided EPZ incentives to finance zone infrastructure development and trade finance activities?	MOF, IPC, MOI
3. Establish "one-stop" processing of EPZ investor applications	- Automaticity of EPZ user approvals. - Complete centralization of authority to approve EPZ applications. - Single application form/requirements for entire incentives package. - Maximum review period and default mechanism for automatic approval.	- Automatic registration of EPZ firms pending review of the application or finite application review and approval period? - Determine configuration of, and authority ascribed to, the EPZ Authority.	MOF, Central Bank, Customs, Office of the President, MOI, MOC, Attorney General
4. Eliminate import and export constraints.	- Exemption from quota restrictions, Customs duties, taxes, import and export licensing bond requirements for EPZ imports/exports. - Single point Customs inspection at EPZ.	- Determine eligibility of vehicles and fuel for duty exemption. - Consider exemption/reduction of port handling and storage fees for EPZ firms.	MOF, Customs, Central Bank, MOC, KPA
5. Comprehensively remove taxes.	-Income and dividend tax exemption. -Loss carry-forward provision.	- Determine length of tax holiday; exemption from other taxes (VAT, real estate, expatriate taxes); and onset of tax holiday.	MOF

FIGURE 5-1
KENYAN EPZ POLICY MATRIX
(Continued)

Policy Objectives	Key Elements	Issues to be Considered	Lead GOK Institutions
6. Liberalize foreign exchange access.	- Guaranteed and unrestricted access to foreign currency through control over foreign exchange accounts by EPZ firms. - Free remittance of profits, dividends, and capital gains. - Independent control over foreign exchange earnings.	- Determine mechanism for access (e.g., foreign exchange accounts in commercial banks, Central Bank EPZ window) for both foreign and local EPZ firms. - Determine role of commercial banks.	MOF, Central Bank
7. Ease labor regulations.	- Preferential access to expatriate work visas. - Equal treatment of male and female employees.	- Define visa allocation procedures, determine length of visa, automatic renewal. - Existing restriction on female employment at night.	MOF, Office of the President, MOL
8. Remove other regulatory constraints.	- Exemption from industrial registration, trade licensing, and local licensing requirements, including prohibition on retail and wholesale sales by manufacturers. (See No. 10 below.)	- EPZ certificate as sole licensing requirement for EPZ users/developers, available solely through the EPZ Authority	MOF, MOC, MOI, Office of the President
9. Promote EPZ linkages to the domestic economy.	- Treatment of sales by local firms to EPZ users as exports, and thus eligible for export incentives.	- Develop other incentive schemes to encourage indirect exports through sales to EPZ users. - Reorient Export Compensation scheme to emphasize sales to EPZ firms.	MOF, Customs
10. Access to local market for EPZ firms.	- Allow local sales of up to 20 percent of production of EPZ firms, subject to payment of all duties, taxes, and surcharges.	- Mechanisms/criteria for case-by-case approval of requests for local sales.	MOF, Customs
Additional Incentives:			
1. Allowance for private provision/financing of basic services.	- Private financing and/or ownership of EPZ infrastructure and services (roads, power, telecommunications systems and service, etc.).	- Types of services/utilities to be eligible. - Form of private involvement (full ownership, joint venture, BOT-style arrangements, etc.). - Limitations on non-EPZ access.	Ministry of Works, MOF, and all parastatal service providers
2. Facilitate access to financing.	- Ease restrictions on local borrowing by foreign EPZ firms. - Remove any taxes on interest payments on foreign borrowing. - Ease restrictions on commercial bank lending.	- Determine percentage of paid-in equity capital that can be borrowed locally. - Remove 15 percent agricultural component requirements for commercial bank lending.	MOF, Central Bank

land policy with regard to foreign ownership of land is required. If foreigners are restricted to leasing land from the GOK, the length of the lease, the provisions for lease renewal, and the right of compensation for improvements must be clearly stated. Under existing land regulations, a private EPZ would be adversely impacted. Finally, it would be advantageous for the approval time for GOK land development plans were both specified and short.

C. RELATION OF PROPOSED INCENTIVES TO CURRENT PRACTICE

5.49 The EPZ program outlined above builds on the existing system of incentives for investment and exports by introducing new or expanded incentives to create a truly competitive export manufacturing sector. When considered in the context of current practice, the measures recommended for the EPZ regime represent radical departures from the incentives package now available. The EPZ program represents a radically different approach to investment and export incentives and their implementation. Rather than relying on slow-moving, discretionary, and uncertain government regulatory decisions at virtually all steps, for the special sector comprising firms qualifying as EPZ entities the granting of EPZ benefits/incentives would be automatic.

5.50 As shown by Figure 5-2, the proposed EPZ regime differs from the Manufacturing Under Bond scheme in two basic ways: the substance and comprehensive nature of the incentives and the automatic measures to implement the incentives. The incentives package proposed for the EPZ regime greatly liberalizes what is available under the MUB, by offering income tax exemptions, allowing full retention of export earnings and guaranteeing repatriation of capital and profits linked to the degree of foreign ownership. In addition, as discussed in the next chapter, significant measures have been proposed to streamline access to the package of incentives through an automatic "default mechanism" and other provisions.

FIGURE 5-2

COMPARISON OF THE MANUFACTURING UNDER BOND SCHEME AND PROPOSED EPZ REGIME

	Manufacturing Under Bond	*EPZ Incentives*
Eligibility Requirements For Incentive Regime	Case by Case Foreign & Domestic Origin Preference Given to Joint Ventures	100% Export Firms Zone Developers Foreign & Domestic Origin
Application Review Period	90-180 Days	Guaranteed Within 30 Days
Income Tax Treatment	Not Available	10-Year Tax Holiday; flat 15% tax thereafter
Capital/Profits Repatriation	1-2 year waiting period	Unrestricted
Management Of Foreign Currency	"Green Channel " Scheme	Independent Foreign Currency Accounts Permitted
Duty Treatment For Imports	100% Exemption On Production Imports and Most Capital Equipment Subject to Payment of Bonds	Automatic 100% Exemption In Perpetuity On All Imports
Duty Treatment For Exports	Subject to Export Licensing	Automatic 100% Exemption In Perpetuity On All Exports
Customs Service	Point of Entry Or In-Bond Transit	Expedited On Site
Alternative Provision Of Infrastructure/Amenities	No	Yes
Preferential Access To Expatriate Work Permits	None	Guaranteed
Sales to Local Markets	Not Allowed	20% of Annual Production

VI. PROPOSED EPZ INSTITUTIONAL AND ADMINISTRATIVE FRAMEWORK

A. ALTERNATIVE INSTITUTIONAL MODELS FOR IMPLEMENTATION OF EPZS

6.01 A wide range of alternative institutional structures have been employed in the regulation of EPZs. 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.

6.02 With this caveat, it is possible to examine the different regulatory configurations used in EPZ programs around the world. Regulatory bodies can be segmented under two broad classifications. One classification relates to the placement of the regulatory body within the overall government structure. The second classification has more to do with the roles undertaken by the regulatory body.

1. Basic Structures

6.03 EPZ regulatory systems can take various forms. These include:

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

6.04 In considering these alternative models, it is important to note that the lines of regulatory authority and definition of responsibility are implicit or can overlap in many EPZ-sponsoring nations. This is most often the case in those countries where the EPZ programs have evolved over time and are legally founded upon the application and implementation of multiple pieces of legislation. Nevertheless, the broad categories listed above can be useful in considering the alternatives available for Kenya.

6.05 **Non-coordinated frameworks**. The most common regulatory environment found in EPZ countries is the uncoordinated regulatory structure. This is the polar opposite of what is known as a one-stop-shop. In essence, a non-coordinated effort requires much of the investor (particularly foreign investors who are unfamiliar with workings of the local bureaucracy) as he or she 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.

6.06 This type of framework is being utilized in Mauritius, the Dominican Republic, and El Salvador. The success of the first two programs, however, should not be construed as an endorsement of this approach. In both cases, it took more than a decade for EPZ programs to establish reputations for predictable and virtually automatic approvals of EPZ applications. EPZ programs in Mauritius and the Dominican Republic have succeeded despite the regulatory environment, not because of it. Mauritius, for example, has an investment process of as many as 25 steps after an investor has received the EPZ certificate. As a result, it typically takes an enterprise three to six months to become operational after approval as an EPZ firm is granted. If not for confidence in the predictable nature of the approval process and the low-cost factors of production, few foreign investors would tolerate such delays.

6.07 **Inter-ministerial committee frameworks**. A second option is to create an inter-ministerial committee for the regulation of EPZs. 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.

6.08 Under the inter-ministerial framework, the inclusion of Customs and the Central Bank is most critical, as these two agencies bear responsibility for key aspects of the program's implementation. As noted in previous chapters, the expeditious processing of imports, exports, and foreign exchange is vital to the success of an EPZ program.

6.09 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 base or interest to make effective contributions.

6.10 The strength of inter-ministerial committees is that they can reduce the potential 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.

6.11 **Single ministry frameworks**. The third option, placing the authority for regulating the EPZ 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 decisionmaking, is seldom accompanied by the requisite inter-agency communication and broad-based support for the program to ensure that such decisions are effectively executed.

6.12 **Autonomous public sector bodies**. Nearly every EPZ 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, and there examples of autonomous, public sector regulatory bodies which function in this manner.

6.13 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, Cape Verde, 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.

6.14 **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 being established in Togo and Cameroon.

6.15 The great strength of this configuration is that the organization is more likely to understand the needs and problems of EPZ 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 EPZ 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.

2. Core Functions of EPZ Regulatory Agencies

6.16 EPZ regulatory agencies undertake a wide variety of tasks, but core functions include designating zones, approving investor applications, monitoring compliance, "trouble-shooting" problems, compiling statistics of EPZ growth, and identifying opportunities for future policy enhancement.

6.17 In addition, regulatory bodies have commonly conducted two other tasks, promotion of the EPZ program, and development and management of zones. The ability of regulatory bodies to effectively accomplish these latter tasks varies from program to program. The Corporacion de la Zona Franca (CZF) in Costa Rica, the General Authority for Investment and Free Zones in Egypt, and the free zone authorities in Liberia and Senegal, for example, have been unable to promote or develop zones effectively.

6.18 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 EPZs. This deficiency has partly resulted from the fact that private sector representation in these organizations tends to be limited or non-existent. The importance of a strong private sector voice cannot be underestimated, especially in socio-political environments where the relationship between the public and private sectors is strained. When the local private sector lacks confidence in the public sector, it is often necessary for the private sector to establish a majority presence in order to reclaim private sector trust.

B. THE KENYAN CONTEXT

6.19 As described in the preceding section, regulatory bodies of differing structure and composition have been successful (to varying degrees) in guiding the efficient and equitable development of a national EPZ development program. In determining the optimal configuration for such a body in Kenya, consideration must be given to not only the lessons learned from other countries, but also to Kenya's past experience in structuring similar implementation entities, and the capabilities and constraints that can be identified within the existing institutional structure(s). The scope of this study does not include a comprehensive institutional assessment of the GOK. Based upon the investigations conducted, however, basic conclusions can be drawn with implications for structuring a Kenyan EPZ Regulatory Authority.

1. GOK Institutions With a Role in the EPZ Program

6.20 For some time, the GOK has been considering the initiation of an export processing zone regime as part of its portfolio of programs in support of export expansion and diversification. The EPZ concept was formally introduced by the GOK in the Sessional Paper of 1986 as a potentially attractive export promotion mechanism, but was tabled in favor of the effective implementation of the Manufacturing-Under-Bond program as a more viable near-term alternative. However, the 1989-93 Development Plan included the development of an EPZ regime as part of the incentive schemes to be developed by the government, indicating that an Inter-Ministerial Committee would be established to "work out the details" of establishing EPZs at the Jomo Kenyatta Airport and the Port of Mombasa during the first half of the Plan period. The EPZ initiative was mentioned again in the 1989 Budget Speech, delivered by the Vice President and Minister of Finance, at which time the acquisition of land by the GOK in Nairobi and Mombasa for EPZ development was announced.

6.21 The Ministry of Finance/Treasury (MOF) chairs the Inter-Ministerial Committee on EPZs and the Ministry is now leading the effort to develop a

national EPZ program for Kenya.[1] The MOF is the primary GOK institution involved in the definition of national economic and fiscal policy and plays a central role in developing and refining the national strategy for economic growth through Sessional Papers, annual budgets, contributions to the National Development Plan, and other official GOK policy documents.

6.22 The MOF is also integrally involved in the implementation of established GOK export and investment policy. From an operational perspective, the MOF includes within its portfolio the Central Bank of Kenya, the Customs and Excise Department, and the Investment Promotion Centre. The duties of the Central Bank and Customs are clearly integral to the implementation of an EPZ program, regulating the movement of foreign exchange and merchandise into and out of the country. The IPC is charged with assisting and facilitating investments in Kenya through general promotional efforts and the establishment of a "one-stop-shop" for investment approval. These three entities are of critical importance in the implementation of the GOK's export promotion efforts, and will play a pivotal role in the EPZ program once it is established.

6.23 Two other ministries are represented on the EPZ Committee. The Ministry of Industry coordinates international donor assistance for industrial development, identifies new industrial projects, and promotes the involvement of local businesses in industrial development initiatives in Kenya.[2] The Commissioner of Lands (Ministry of Lands and Settlements) -- the office which oversees the development of Government lands and regulates all land use in Kenya -- is also a Committee member.

6.24 Although not a member of the EPZ Committee, the Ministry of Commerce also has an interest in the development of the EPZ program. In 1981, (as the Ministry of Commerce and Industry) the Ministry's Department of External Trade sponsored a feasibility study of the development of EPZs at Mombasa and Nairobi. At that time, EPZs were being discussed as a potential element of the GOK's export promotion package. Although the study was completed and results were favorable, follow-up action was not taken by the GOK. At the present time, the interest of the Ministry in the EPZ initiative is primarily the potential for integration of the EPZ program in its ongoing efforts to promote international trade and export expansion through its Department of External Trade (formerly KETA).

---

[1] At present, the MOF has five representatives on the EPZ Committee in addition to the Chairman: Advisor to the Ministry; Managing Director of the IPC; Government Investments Department; and Director of External Resources.

[2] The Ministry of Industry is also the umbrella agency which encompasses the major GOK financial and infrastructural parastatals involved in industrial development, including the Industrial and Commercial Development Corporation, the Industrial Development Bank, and Kenya Industrial Estates.

2. Models of Potential Institutional Alternatives in Kenya

6.25 Successful EPZ programs have been effectively administered by regulatory entities ranging from ministerial offices to inter-ministerial commissions to parastatals to private, non-profit corporations. For an EPZ regime to function effectively, however, the effective consolidation of authority for the program within a single institution is optimal.

6.26 In determining the optimal structure for the Kenyan EPZ Authority (EPZA), special attention must be directed toward arriving at a configuration that will:

- stimulate cooperation and mutual confidence between the private and public sectors;
- incorporate safeguards against the politicization of the regime;
- provide institutional autonomy for the regime's effective implementation;
- ensure that the entirety of the institution's resources and energies are dedicated to the establishment and implementation of the EPZ program; and,
- be clearly recognized as a departure from the institutional frameworks that have proven less than successful in the past.

6.27 It is the opinion of the TSG team in light of these factors, that the Kenyan EPZ Authority should be an entirely new entity. Given the potential importance of the program and the major step toward economic liberalization that it represents, it should not be simply added to the portfolio of an existing institution. Such an approach might reduce the EPZ's perceived priority and visibility in Kenya's marketing and promotion initiatives, as well as dilute the focus of the administering body upon the EPZ regime.

6.28 For the purposes of this analysis, two relatively recent Kenyan institutions, the Investment Promotion Centre (established in 1982) and the Capital Markets Authority (1989) offer guidelines on how a new regulatory body for the EPZ program might best be established. The relative merits of each model are discussed below.

a. Investment Promotion Centre

6.29 **Objectives and Functions.** The Investment Promotion Centre was first established in 1982, as a department of the Ministry of Finance, to serve as the GOK office for facilitating investment. In 1986, the Investment Promotion Centre Act was passed, establishing the Centre as an independent legal entity. The portfolio of the IPC was expanded under the Act beyond direct investment promotion to include the following: liaise with the Central Bank regarding foreign exchange control; liaise with relevant Ministries responsible for investment approval; assist investors in project implementation and monitoring of the projects to ensure compliance; and to advise the GOK on policies and procedures related to investment.

6.30 **Legal Structure.** Under the Act, the IPC was constituted as a GOK parastatal agency, governed by a mixed public-private sector Board of Directors. The public sector Board members include the Chief Secretary; Permanent

Secretaries of the Ministries of Finance, Planning, Commerce, Industry, Local Government, Lands, Agriculture, and Tourism; the Governor of the Central Bank; and the IPC Managing Director. In addition, the Board is to include not less than five and not more than nine private sector representatives, appointed by the President. The Chairman of the Board is appointed by the President and is currently the Permanent Secretary of the Ministry of Finance. As presently constituted, the IPC Board has 21 members, 6 of whom are from the private sector.

6.31 **Management and Funding**. The day-to-day management of the IPC is carried out by the Managing Director, and it maintains a professional staff that includes five technical officers. Funding for the Centre's operations is provided by the Ministry of Finance.

6.32 **Role as a One-Stop-Shop**. When the IPC was legally constituted as a separate corporate entity in 1986, one of the primary intentions of the GOK was to establish a one-stop-shop within the Centre to facilitate investment procedures. This function is a key aspect of leading EPZs worldwide, and integral to the effective implementation of an EPZ program. However, as discussed in Chapter 3, the IPC has fallen short of this objective, as delays in granting approvals are frequent, and the approvals themselves are not comprehensive; investors are still required to obtain licenses and permits from individual GOK offices.

6.33 To a great extent, the problems that have been encountered in the utilization of the IPC as a one-stop shop rest in the legal configuration of the institution.[3] The "Investment Facilitating Committee" within the IPC does not have the legal authority to approve investments. Instead, the IPC serves simply as a liaison (as prescribed in the IPC Act) between the prospective investor and the GOK offices where the true authority lies. This is true even though the key GOK ministries are represented within the Facilitating Committee. The GOK Committee members can only make recommendations to their respective ministries for approval of an application, they have not been delegated the authority to grant such approval themselves. Therefore, although the establishment of the one-stop-shop has (in some respects) centralized the contact point between a potential investor and the GOK, it has not centralized the decision-making authority to evaluate the application. The advisory role played by the IPC in the processing of investor applications has in fact added an additional step to the investment approval process.

6.34 As originally envisaged, approval of an application by individual GOK offices once favorably reviewed by the IPC was to be essentially automatic. However, approval has proven to be subject to similar delays as in the past. Moreover, once the application is approved, there are still licenses and permissions that must be obtained by the investor, as is the case with expatriate work permits and import licenses. The IPC functions as an inter-ministerial

---

[3] Another major constraint on the IPC's efficiency is the lack of explicit criteria for evaluation of investment applications. In addition to contributing to perceptions of an overly discretionary approval process, the subjective nature of the evaluation often results in delays in processing.

advisory committee without independent authority. Although it includes representation of the GOK ministries and offices that will also play a part in the implementation of the EPZ regime in its directorship, it does not constitute a suitable model for the EPZ Authority.

b. Capital Markets Authority

6.35 In November 1989, an Act of Parliament was passed creating the Capital Markets Authority (CMA), an autonomous regulatory body to oversee the development of "an orderly, fair and efficient capital market in Kenya." The passage of this Act was in keeping with various GOK policy announcements such as those contained in the Sessional Paper No. 1 of 1986 on Economic Management for Renewed Growth and the recommendations of an earlier study by the Central Bank and IFC on the Development of Money and Capital Markets in Kenya (1984). The development of the Act has been shepherded by a Capital Markets Advisory Council, a public/private working group formed under the direction of the Ministry of Finance to lay the groundwork for passage of the law. The Advisory Council has sixteen members: five GOK officials and eleven private sector representatives, encompassing all segments of participants in the industry -- i.e. insurers, brokers and underwriters, bankers, etc.

6.36 Although the content of the Act, of course, bears little similarity to the recommended elements of the EPZ legislation, the institutional framework it establishes holds implications for the proposed configuration of the EPZ Authority. The key elements of the CMA, as structured, are outlined below.

6.37 **Corporate Structure.** The CMA is an independent legal corporation, capable of engaging in all forms of business and corporate transactions.

6.38 **Board of Directors.** As recommended in the 1984 study, the composition of the Authority is heavily weighted in favor of private sector participants. The CMA Board of Directors is made up of the following individuals:

- Chairman, appointed by the President, based upon the recommendation of the Minister of Finance;
- six private sector representatives appointed by the Minister of Finance;
- Permanent Secretary of Treasury, or his designate;
- Governor of the Central Bank, or his designate;
- Attorney General, or his designate; and,
- Chief Executive of the Authority.

6.39 Of the 11-member Board, it is expected that the Chairman will be chosen from the private sector and that the Chief Executive will be a GOK official, resulting in a total of seven private sector and four GOK members. The private sector representatives are appointed by the Minister of Finance to three-year terms and are eligible for re-appointment upon expiration of that period.

6.40 **Powers and Functions.** Much like the role of the IPC in investment approval, the policymaking function of the CMA is to serve as an advisor to the MOF on all issues related to the development of capital markets in Kenya.

However, among its responsibilities, the CMA is also independently (except as noted) empowered with the authority to:

- implement GOK policies and programs with respect to the market and securities;
- frame rules within its jurisdiction;
- establish criteria for the granting of authority to operate as a stock exchange and to issue approval in consultation with the Minister;
- to grant business licenses to persons to operate as dealers, brokers, etc.;
- investigate and monitor the operations of any approved or licensed businesses or persons;
- inspect all records of approved or licensed persons or businesses; and,
- undertake all such other acts as may be conducive to the attainment of the objectives of the Act.

6.41 The CMA thus essentially has operational and decision-making autonomy under the Act. With the exception of the granting of approval to operate as a stock exchange, the entire spectrum of duties related to the establishment, implementation, and regulation of the capital market are fully within the portfolio of the CMA. This is in marked contrast to the IPC's one-stop-shop functions, which are restricted to an advisory capacity, and is especially notable given that the majority of the seats on the Board of the CMA is held by the private sector.

6.42 **Management and Funding.** The CMA's Chief Executive, a public sector appointee, is the managerial and operational head of the Authority, charged with its direction and control. According to the CMA Advisory Council, the intention is to keep the staff of the Authority to a minimum, consisting of a small professional team of economists, financial analysts, accountants, and lawyers. Funding for its operations will be provided by the fees generated and payments received by the CMA under the Act, apparently augmented by public expenditures.[4]

6.43 In its organizational structure, functional authority, and basic operational characteristics, the CMA provides a Kenyan model that should be considered in configuring the EPZ Authority. Key positive attributes include:

- corporate and operational autonomy;

- full authority to execute all functional aspects of its institutional objective;

---

[4] The Act itself does not specify the use of public funds to finance CMA operations. However, it is so indicated in the attached "Memorandum of Objects and Reasons" which states that "the enactment of this Bill will result in additional expenditure of public funds which will be provided for through the annual estimates."

- representation on the Board of all public sector bodies related to the implementation of its program; and,

- majority private sector representation at the Board of Director level to ensure that the institution reflects an understanding of the needs of the business community.

6.44 One of the primary objectives in the drafting of EPZ legislation is to create an institution that operates as a joint commitment of the public and private sectors. The CMA, as configured, is an important precedent. In discussions with GOK officials, the Kenyan manufacturing sector, and local attorneys, there was widespread agreement that the CMA Act is a pathbreaking piece of legislation and an appropriate template for the design of the EPZ Authority.

C. PROPOSED CONFIGURATION OF EPZ REGULATORY BODY

6.45 As noted above, the ability of a Kenyan EPZ Authority to effectively execute its functions will rest in large part on the organizational structure set forth in the legislation. Drawing upon the experiences of the GOK in the design and implementation of the other regulatory entities, and the models employed in other EPZ-sponsoring countries, it is recommended that the EPZ Authority embody the characteristics outlined below.

1. Structure and Objective

6.46 The fundamental objective of the EPZ Authority should be to promote export sector employment and foreign exchange earnings through administration of an internationally competitive EPZ incentives regime. To provide an organizational framework compatible with this objective, the following structural characteristics of the EPZ Authority are proposed:

6.47 **The EPZA should be structured as a non-profit, non-stock corporation dedicated to the administration of the EPZ regime.** The EPZA should be an independent entity; legal autonomy is the foundation of effective, independent decisionmaking and action. A non-profit status will help to ensure that the goal of the EPZA is to promote national economic development rather than to achieve its own ends and, as a non-stock entity, that it can act impartially, free from the controlling influence of any parts of its diverse constituency.

6.48 **The Board of Directors should be limited to nine members.** The Board of Directors will be responsible for interpreting the EPZ legislation and its accompanying operational regulations to determine how best to implement the program. It will also be called upon to make decisions regarding the designation of EPZ projects and user status, key elements of the program for which effective, timely decision-making is crucial. It is therefore preferable to keep the Board to a relatively small core group that can meet frequently and work together efficiently in reaching and implementing its decisions.

6.49 **Private sector representatives should constitute the majority of the Board membership.** It is recommended that five of the nine Board members be representatives of the private sector. This structure has been approved by the Government of Kenya for the CMA and should be imposed in the EPZ Authority as well for numerous reasons. Full support of the Kenyan private sector is absolutely essential if the EPZ program is to succeed; the mutual distrust that has characterized public/private sector relations is widely recognized as a fundamental obstacle to the economic growth of the country. On an operational level, lack of effective communication between the two groups has limited the success and slowed the implementation of GOK efforts to promote economic liberalization through MUB and Export Compensation, for example. While such programs are acknowledged by the private sector as a step in the right direction, they fall short of the expressed needs of the business community in their design and scope, and are problematic in their implementation.

6.50 While some East Asian countries have proven successful in developing EPZs under the regulatory guidance of a public sector institution, such settings differ greatly from the Kenyan context. In countries such as Taiwan and South Korea, the government has historically directed and supported the actions of the private sector in a form of mixed partnership that has combined positive elements of each group. The foundations for such a policy approach to succeed are not present in Kenya. The proposed EPZ legislation will remove many of the structural and policy constraints that have been identified in this study. However, in the absence of a decisive action that will have a profound impact on prevailing investor perceptions, passage of the Act may be viewed as only a "paper commitment" by the foreign and domestic business community.

6.51 **The Chairman and other public sector Board members should be appointed by the President, or his designate, and should represent the key offices involved in the design and implementation of the EPZ regime.** In order to ensure that the actions of the Board fairly represent and reflect GOK policy and interpretation of the EPZ legislation, the President should appoint the Chairman of the Board of Directors. It is also recommended that key entities involved in the program's design and implementation, such as Finance (Central Bank and Customs), Commerce, Industry, and others be included on the Board, to facilitate effective communication and operation.

6.52 **Private sector representatives on the Board should be selected by the Kenyan business community.** While both the IPC and CMA have private representation on their Boards, these individuals are appointed by the GOK, and can thereby be perceived to reflect its interests. In support of the establishment of an independent authority that is removed from political pressures, and to guard against perceptions of partiality, it is recommended that leading private sector organizations in Kenyan appoint their own representatives to the Board. This is a common practice in EPZs that provide for private sector representation, in order to ensure that its composition truly reflects the views of the business community. Under this approach, the Kenyan Association of Manufacturers, Kenyan Chamber of Commerce and Industry, the association of EPZ users (once the program is operational), and other business organizations, would elect the representatives of their choosing. Such a measure from the GOK would be a strong sign to the private sector that the EPZ program

represents an innovative, cooperative approach to the implementation of economic policy.

6.53 **The EPZ Authority should serve as a true "one-stop-shop," empowered with the breadth of authority required to fully implement the EPZ program.** The point cannot be made strongly enough that even the most generous and competitive EPZ incentive package is not sufficient to offset the negative effect of complexities and procedural shortcomings in its implementation.

6.54 In this light, it will be essential for the EPZA to be granted full authority to issue licenses for both EPZ users and EPZ projects and to monitor their compliance under the program, as a means of ensuring that the accompanying benefits are effectively implemented.[5] If desired by the GOK, the President may serve as the final authority for approval of designation of a multi-user EPZ complex, given the size and scope of these projects. The EPZA will rely upon the cooperation and support of the GOK agencies involved in the practical administration of EPZ incentives. Offices such as Customs, the Central Bank, the Office of the President (expatriate work permits), and the Port Authority, must therefore recognize the authority of the EPZA to grant incentives to EPZ users and developers that will require the full cooperation of each office if they are to be effectively implemented.

2. Staffing and Functions

6.55 It is recommended that the staffing of the EPZA be kept to a minimum: sufficient to execute its functions but lean enough to ensure that the organization is responsive to the needs of investors. The Chief Executive should be a full-time position, selected by the Board, and be responsible for providing strategic direction, hiring of staff, setting of wage levels, and discharging all other senior management functions. He/she should be assisted by legal counsel, as required, along with other clerical and support staff as deemed appropriate.

6.56 The EPZ enabling legislation will establish the legal foundation for the establishment of the Kenyan EPZ program. In addition, supporting regulations must be issued by the GOK that set forth the basic operational procedures for the program's implementation. The primary function of the EPZA will be to administer the effective implementation of these legal instruments as they are applied to zone developers, users, and service providers; to approve investor applications; and to monitor compliance. In addition, counterpart organizations in other countries often function as "trouble-shooters" on behalf of EPZ

---

[5] It should be noted that EPZ program beneficiaries would be bound to conform to all legal requirements for firms doing business in Kenya, apart from those areas that are specifically cited in the EPZ legislation. With regard to prevailing legislation, e.g., health and sanitation, child labor, environmental standards, etc., the enforcement authority of the relevant GOK agency would not be affected by a firm's EPZ status.

developers and industries in their dealings with other government and parastatal bodies.

6.57 EPZ experience worldwide has repeatedly demonstrated that regulatory and zone development functions should not be combined in the same institution. This is especially true for countries that wish to promote the active participation of the foreign and domestic private sector in the development of EPZ projects. Opportunities for perceived and actual conflict of interest are multiplied when the entity charged with guiding and monitoring EPZ performance is simultaneously one of the EPZ operators being monitored.[6] In the Kenyan context, the importance of avoiding conflict of interests is essential to allay concerns over the potential politicization of EPZ operations.

D. KEY EPZ ADMINISTRATIVE PROCEDURES

1. Recommended Application Procedures for EPZ User Status

6.58 The granting of substantial incentives and exemptions from existing government regulations and taxation always requires critical review by the responsible authorities. One of the principal objectives of an EPZ 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 EPZ users should be relatively simple; those for authorization of EPZs will be relatively infrequent and may require greater scrutiny. They are discussed separately below.

6.59 As export-oriented operations, the firms applying for EPZ status should require a simple verification process. The purpose of the regime is to encourage investment in export industries, rather than to control and direct investment. It is unlikely that a proposed investment in the export sector would be denied, except on grounds that the investor would be violating Kenyan law or was fraudulently representing himself.

6.60 The following elements of the investment approval process should be set forth in the EPZ legislation:

- application to a single government office authorized to issue "EPZ user status" under the regime;
- simple application form;
- 30-day review period from submission of a completed application;

---

[6] Government participation in the physical development of EPZ projects is generally best restricted to the installation of external infrastructure "up to the gate," of privately developed EPZs. In those cases where the government elects to become actively involved in zone development, such activities should be undertaken by a different office than that charged with regulatory authority over the national EPZ program.

- explicit criteria for approval or denial; and,
- qualification for all incentives based on the one application.

6.61 To apply for EPZ incentives, prospective zone users and zone-based service providers should present basic data on the firm and the proposed project, to be verified by the government in its evaluation of the investment. There is normally no need for extensive elaboration of a market study or "feasibility study," particularly for foreign firms sourcing to the parent company or established markets. The following information should be sufficient to evaluate prospective projects:

- name and domicile of all shareholders, including parent company;
- equity distribution of shareholders;
- financial references (commercial bank);
- amount of proposed investment;
- source of financing for fixed investment and working capital;
- capital equipment to be imported;
- description of production process and products;
- principal markets for production;
- principal imports and local sources of raw materials and intermediate goods;
- number of jobs to be created and description of positions;
- expatriate work permits required, with position description;
- proposed location or facilities requirements; and,
- any potential impacts of the project on the environment or on surrounding businesses.

6.62 Utilization of a standard application form will both help to ensure that firms are assessed on an equal basis and simplify the review process for the EPZA staff. As a further safeguard against delays in processing, it is strongly suggested that provision for a <u>default mechanism</u> be included in the EPZ legislation, authorizing automatic approval of applications for EPZ user status if no ruling has been issued by the EPZA within the specified review period. The evaluation conducted by the EPZA will consist primarily of verification of the information presented, and an extensive review is both unnecessary and a deterrent to investment. The imposition of a default mechanism will help to ensure that a one-stop-shop truly functions as such.

6.63 Applications for EPZ user status would not be accepted which did not meet minimum export requirements (80 percent of total output as recommended in Chapter 5), or for which no or inadequate references were available for the principals involved. It is to be expected that firms will supply evidence of their capabilities to carry out the proposed investment, either through descriptive corporate materials, references, or demonstration of successful projects elsewhere. The evaluation by the EPZA then would consist of ensuring that the proposed investor was legitimate, that the products to be manufactured involved no problems of compliance with local laws or posed any other kind of threat.

6.64 In Kenya, it is also very important that the application include information regarding the probable impact of the project on the environment. GOK policy has placed an emphasis on preserving the wealth of natural resources and the superior quality of the environment that now characterizes Kenya, and

on careful investigation of the effect that any proposed development might have on the priority sectors of tourism and agriculture. While firms utilizing the EPZs are most likely to be engaged in light manufacturing operations, any investments which would have a lasting, deleterious effect on the environment should be prohibited. In those instances where determination of the potential impact of a given project on the environment is not possible based upon the information available, the GOK can request the applicant to finance and execute an Environmental Impact Assessment, in keeping with the relevant regulations as set forth in the laws of Kenya.

6.65 Approval of the user applications should be officially extended through the issuance of an EPZ Business Certificate. This Certificate would then serve as the basic document to present to Customs, the Central Bank, the Kenya Ports Authority, and any other agency which may require evidence of EPZ status. The Certificate should be made in the name of the Kenyan company which will be set up as an affiliate, or in the name of the branch of the foreign firm. Procedures of incorporation or registration would be followed as they apply to any firm.

6.66 In all respects the EPZ firm must comply with existing Kenyan laws governing public health, safety and human rights; EPZ status merely indicates that it is entitled to the incentives specified under the law. To the extent that interaction with other government agencies is required, for example in the issuance of expatriate work permits, responsibility for obtaining needed permits should be handled directly by the EPZA upon application of the EPZ firm. The EPZ Business Certificate could be revoked at any time for violation of laws or regulations, including the provisions of the EPZ law, or upon cessation or dissolution of the enterprise.

6.67 This approach to investment approval under the EPZ regime represents a streamlined procedure designed to elicit the necessary information from prospective firms and maintain control over the qualification for the incentives by the EPZA, without introducing the disincentive of unnecessarily complex and lengthy procedures. Once adopted, it could of course be modified with the announcement of additional criteria required for qualification of new investments. It is likely, however, that the need to introduce any such criteria would only arise once the program was well established and began to introduce resource constraints or other problems.

2. Recommended Procedures for EPZ Designation

a. Facilities for Multiple Users

6.68 In contrast to the procedures for approval of EPZ enterprises or user industries where a relatively large number of applications can be expected to be handled on a more or less routine basis, the designation of EPZ complexes will involve a more deliberate planning and development of large, discrete projects. In this case, the preparation of a typical feasibility study will normally be required as part of the pre-investment planning. In many cases, the project will involve close coordination with the government, especially in the areas of acquisition of land and provision of external infrastructure for the zone. However, this does not necessarily require that the designation of the site as

an EPZ be contingent on all these other factors. The EPZA will need to evaluate the proposed project from the standpoint of its relation to an overall zone development strategy, any support requested from the government, and the general viability of the project. These considerations can normally be assessed from the following information, as specified in the legislation or implementing regulations:

- physical master plan, showing facilities proposed and overall layout;
- proposed ownership and management structure, services to be provided;
- construction schedule;
- estimation of demand; market/sector orientation;
- proposed security measures to ensure lawful operation;
- capital cost estimate and financial projections; and,
- leasing/sale arrangements and proposed rates.

6.69 This information should be submitted to the EPZA by each applicant for zone designation, in accordance with a framework established by the Authority. In addition, it is recommended that the applicant submit verifiable evidence of either ownership or a lease option of the land to be developed. In the case of leasing of the zone property, the applicant need not have entered into a formal contract, given that his interest in leasing the property is likely to be directly linked to receipt of the EPZA's approval for the zone. The applicant should, however, be able to demonstrate that he has a legally valid option on the site, for a minimum of a thirty-year lease.

6.70 The EPZ legislation will specify industrial or service activities that are universally prohibited from establishment within any Kenyan EPZ. In other countries, this "negative list" generally includes the manufacture of firearms, illegal or controlled substances, as well as "high-pollutant" industries. For the most part, EPZ projects that are developed in Kenya will be oriented toward light industry with standard facilities and services requirements and a minimal impact on the environment. However, it is important that basic analysis be conducted by the developer to determine the site's soil conditions, hydrology, vegetation, area land-use and infrastructure availability, to assess whether there are any characteristics that would preclude development as an industrial, office or mixed-use facility.

6.71 Factors such as these should be assessed as part of the engineering and technical studies conducted in pre-investment analysis, the findings of which will be presented in the application. During its review of an application, the EPZA may decide that the effect of the project on the environment would be unfavorable or that additional investigation is required to determine its impact. In such cases, the applicant would be given the opportunity to conduct further analysis or rectify the shortcoming. Ultimately, if no resolution were reached, the project would be rejected.

6.72 Recently enacted EPZ legislation in other countries provides the opportunity for the alternative provision of basic services/infrastructure within an EPZ complex, which should also be considered by the GOK in Kenyan EPZ legislation. For those applications which include such a proposal, the EPZA will require adequate demonstration of the capabilities of the development group, and/or its co-venturers in the delivery of such services, to successfully fulfill

the requirements of the project as designed, in a manner which is in keeping with national standards and regulations. Such arrangements should be encouraged by the government, and viewed favorably by the EPZA to the extent that they reduce the drain on government resources and improve investment conditions.

b. Special Free Zones

6.73 Firm-specific EPZs or "Special Free Zones," should not be subject to the EPZ procedures described above. Instead, as single-user zone facilities, they must meet the requirements set forth for firms seeking to receive zone user status. One important consideration that should be emphasized here is that firms should not have to "justify" a request for a special free zone designation, but rather be permitted to operate at "locations of their choosing." While the concept has frequently been employed in other countries when a firm's operation is linked to a specific site in terms of its raw material requirements, proximity to transportation, or other locational considerations, it can also apply to export firms that are already operational, for example, and simply wish to avail themselves of EPZ benefits without giving up their existing facilities. All special free zones, however, should be subject to special operational requirements that do not apply to EPZ users, specifically with regard to their interaction with Customs authorities.

3. Regulation of Foreign Exchange

6.74 Justification for a policy of unrestricted accessibility to foreign exchange for the legitimate business needs of zone businesses rests on the fact that successful EPZs continually generate net positive foreign exchange earnings. In other words, the outflow of foreign exchange for a typical zone enterprise -- whether a payment for imported raw materials and/or components, debt service on foreign-sourced loans, equity capital repatriation, or profits and dividends -- will always be a fraction of the foreign exchange inflow which is equivalent to the gross value of export sales. The surplus, roughly equal to the value-added in the zone operation (comprising labor, rent, services and local-source materials, parts and components) accrues in the national accounts under the control of the Central Bank.

6.75 Successful performance in the highly competitive world of international commerce -- especially in the sectors most likely to invest in a EPZ in the region -- requires strict and timely compliance with all international financial obligations. This, in effect, means unrestricted access to foreign exchange and streamlined procedures (i.e., a minimum of "red-tape") in making transfers related to all legitimate business obligations. This fundamental need is across-the-board; it applies equally to EPZ developers and user industries. Wherever foreign capital is invested in facilities producing for export, the timely availability of foreign exchange is crucial to success.

6.76 As outlined above, the following elements related to foreign exchange control should be incorporated in the Kenyan EPZ legislation:

- allow all zone enterprises to directly hold foreign exchange accounts;

- allow zone enterprises full control over foreign exchange accruing in these accounts (after covering all local costs in local currency of the requisite amounts of foreign exchange);

- guarantee automatic access to foreign exchange at all times;

- allow unrestricted repatriation of profits and capital invested in fixed assets; and

- establish streamlined procedures and minimum bureaucratic red-tape in implementing legitimate foreign exchange transactions.

The liberal approach advocated and embodied in the guidelines above would apply to all investors, public or private, whether as developers of zone projects, or as user industries.

6.77 Regarding private foreign investors, there can be little argument with the principle of unrestricted repatriation of capital and profits from their own earned foreign exchange after liquidation of all local currency obligations. The situation, however, is somewhat more complicated with respect to local investors. Obviously, in such cases, if no foreign-sourced capital entered into the enterprise, there is no obligation to repatriate either capital or profits. But if foreign credits or equity openly and legally entered into the capitalization of the project, to that extent the special liberal foreign exchange regime should apply. In addition, the enterprise, as an approved zone business, would have automatic access to retained foreign exchange (from its export revenue) needed to conduct its legitimate operations as would a 100-percent foreign capitalized zone firm. "Legitimate operations" include inter alia: purchase of foreign raw material, parts and components, payment for foreign licenses and patents (royalties) and/or technical assistance, and foreign costs associated with marketing and promotion (business travel and international advertising).

6.78 In addition to the general guidelines discussed above, it should be mentioned that EPZ developers should be entitled to specify rental payments in U.S. dollars or the local currency equivalent. This provision will protect the developer against real income shrinkage due to inflation or currency depreciation.

6.79 In summation, it is recommended that a single special foreign exchange regime, consonant with the needs of zone operations, be designed and made applicable to all EPZ projects, whether owned by foreign or domestic interests, public or private. Detailed procedures governing the various types of transactions should then be formulated in consultation with all relevant agencies (e.g., Central Bank, Ministry of Finance) and included in the EPZ Implementing Regulations, or in Central Bank circulars published at intervals subsequent to the approval of the EPZ legislation.

4. Proposed Customs Concepts and Procedures

6.80 The problems with Kenyan Customs have been examined in detail in Chapter 3 and form the basis of the discussion below which suggests the foundation of a significantly different Customs approach that will be required to successfully implement the EPZ scheme in the Kenyan context. An institutional and regulatory analysis of the Kenya Customs and Excise Department is presented in Annex C; a summary of suggested technical procedures for Customs implementation of the EPZ regime is presented in Annex D.

a. Relationship of Customs to the EPZ Concept

6.81 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.

6.82 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. Although the Customs territory of a country is often a physical area -- usually the country as a whole -- it is also an abstract concept that can be, and often is, defined according to each government's philosophy.

6.83 EPZs 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 EPZs without surrendering their rights and powers to control merchandise crossing their borders.

6.84 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, since duties and import taxes are not to be 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 EPZ operations.

6.85 Similarly, because EPZ 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 a EPZ. 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 EPZs.[1] However, the government's treatment of EPZ merchandise and operations should reflect the inherent differences between EPZ activity and general commerce in the regulatory procedures employed.

b. Preferred Customs Operating Procedures in EPZs

6.86 Governments usually adopt stringent procedures to control merchandise entering the Customs territory of the country. These controls involve physical restraints and examinations, extensive documentary requirements, government approvals, and similar measures to ensure that the merchandise to be imported is legally allowable and that revenue is properly determined and collected. These procedures, necessary as they are for the control of merchandise entering the Customs territory, are in some ways inconsistent with an EPZ operation. In the development of a customs program for an EPZ, three features are essential:

- rapid physical transfer of merchandise;
- reduced documentation; and,
- flexible physical controls during processing.

6.87 As described below, these elements are those most required by EPZ operators and users and, when satisfactorily implemented, make a significant contribution to the success of EPZ operations.

6.88 **Rapid Physical Transfer of Merchandise.** The traditional Customs merchandise control -- physical restraints and examinations, extensive documentary requirements and wide-ranging intra-governmental review and decision-making -- contribute to extending the time required to ship merchandise to its final destination which is of critical concern to EPZ operations. Zone users are often located far from their suppliers and buyers and are already faced with extensive shipping times, even without the delays induced by complicated Customs procedures. In other instances, EPZ businesses are producing merchandise subject to time-sensitive shipping schedules which, if not met, can result in non-sellable merchandise with a corresponding serious financial loss to the manufacturer. Accordingly, the use of government procedures which add to the time required to ship merchandise to and from EPZs is an aggravation and will significantly hinder the development of a successful zone operation.

6.89 **Reduced Documentation.** Reducing documentary requirements -- requiring fewer documents with less information -- expedites the shipment of zone merchandise and increases the efficiency of zone-based businesses. The zone user

---

[1] The usual reasons for compiling EPZ 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.

requires less time to prepare the documentation, and can therefore quickly respond to government requirements in cases where there is little advance notice of merchandise shipments. Moreover, Customs can clear the merchandise more rapidly because there are fewer documents to examine and, generally, fewer individuals involved in the process.[8] Given that EPZ operations require less comprehensive controls than do regular importations, simplifying the documents involved is an obvious technique to expedite merchandise shipping schedules.

6.90 **Flexible Physical Controls during Processing.** Since EPZ merchandise does not enter the national Customs territory, stringent physical controls and direct Customs supervision are not necessary while the merchandise is in the zone. As a result, the EPZ user is able to freely move the merchandise from inventory to manufacturing, manufacture it into a new product, and otherwise manipulate or process it as required without direct government supervision and permission.[9] This facilitates the effective execution of what are often time-sensitive operations and relieves government personnel from the tedious monitoring of merchandise operations, allowing them to devote their attention to revenue collection matters.

c. Customs Control Concepts

6.91 In order to reconcile the needs of government -- to control merchandise entering the Customs territory -- with the apparent conflicting needs of EPZ operators/users for flexibility and speed in merchandise movement, governments have re-evaluated their Customs control procedures with regard to entry and exit of zone goods. If adequate control is exercised over these two matters, EPZ operations can be carried out with a minimum of merchandise diversions into the domestic economy and resulting loss of revenue. Three techniques are recommended to ensure adequate Customs control within the Kenyan EPZ context: (i) physical control; (ii) specialized recordkeeping and reporting requirements; and (iii) computerized data management.[10]

---

[8] Governments have discovered that a hidden advantage to this feature is the ability to divert personnel to more revenue critical matters, such as examination and documentary review of merchandise to be imported into the customs territory upon which duty and taxes are due.

[9] This differs significantly from operations involving "Customs warehouses" where imported merchandise can be temporarily stored without the payment of duty and taxes. In order to move or process the merchandise, documentation must be submitted and permission obtained for each action. Also Customs must witness the operation.

[10] A fourth method, third party guarantees, requires the posting of bonds by EPZ users and is also sometimes used in EPZ programs. Such a practice is not recommended in the Kenyan EPZ regime, where there is a recognized need to streamline the import/export procedures to the greatest possible extent and given the problems that have been experienced in this regard under the existing MUB program.

6.92 **Physical Controls**. Customs control over EPZ operations is traditionally based on direct physical controls -- fenced, guarded geographic areas monitored by Customs or other authorized security personnel who control the flow of merchandise to and from the facility. This control is directed to assure that zone merchandise is indeed shipped to the zone and that it does not depart from the zone without proper authorization. With adequate physical controls, there is little need to monitor the movement of merchandise while in the zone.

6.93 **Specialized Recordkeeping Controls**. A physical control system is appropriate when an EPZ is a specified geographic area occupied by a number of zone users. However, alternative control concepts become necessary when EPZ operations are authorized at separate locations for single users (Special EPZs). In such cases, Customs is faced with burdensome manpower requirements when there are a large number of such operations. In the absence of available manpower, alternative techniques include the use of recordkeeping requirements in which Customs gives the private zone user responsibility to act as an agent of Customs in the safeguarding of zone merchandise through the use of physical controls (fences, guards controlled access), the maintenance of inventory records and the submission of periodic reports of zone operations. Backup controls are provide by periodic Customs examinations and inspections of zone inventory and records. In larger factories, a Customs agent can be permanently available; in such cases all associated costs are borne by the owner/operator of the Special EPZ.

6.94 **Recordkeeping Computerization**. Computers, with their ability to process a large volume of information in a short period of time, are rapidly becoming a highly efficient tool for many Customs operations around the world. This is particularly true for operations that require retention of information over an period of time. For example, computers are highly effective tools to retain information and quickly determine the status of merchandise under temporary admission procedures, stored in bonded warehouses, and under international inland transportation which have not yet cleared final Customs processing.

6.95 Obviously, EPZ operations are a logical choice for computer recordkeeping procedures. Computers can be used to record inventory entering or departing a EPZ and to provide a record of inventory which is remaining in the zone. This same data also helps Customs plan and verify periodic examinations and inspections of inventory in the EPZ. Finally, computerized records provide an organized, readily available source of statistics concerning EPZ activities and merchandise operations. Recently, some countries have allowed EPZ operators/users to maintain computerized recordkeeping systems that meet government requirements for information and control. EPZ operators and users develop computerized systems for their own internal business uses and the additional government requirements are usually of minor impact on their overall operations. In such cases, the system information is used by <u>both</u> the government and the operator/user for EPZ management. The government benefits are meaningful since the computer benefits are available without the cost of equipment and development efforts borne by the zone operator/user.

6.96 A highly innovative practice now employed in some countries is to allow EPZ operators/users to use their systems to maintain the official government records of EPZ operations. In such cases, the government does not maintain detailed inventory records of EPZ merchandise and relies on the information available through the EPZ computers and periodic summary reports submitted by the EPZ operators/users. Of course, the government allows such flexibility only to those businesses who have consistently demonstrated their competency and trustworthiness.

d. Customs Constraints to the Implementation of a Kenyan EPZ Regime

6.97 Kenyan Customs regulations encompass many procedures which can be incorporated into an EPZ program; however, in practice, the procedures include many burdensome regulatory requirements which would be prejudicial to an effective EPZ program. As discussed in detail in Chapter 3, major Customs constraints with the MUB scheme relate to the following:

- extensive documentary requirements, requiring at least 12 documents to facilitate the processing of imported inputs by Customs authorities;

- cumbersome and redundant supervision and inspection procedures separately involving as many as a dozen representatives of Customs, Kenya Ports Authority and other agencies;

- lack of familiarity of Customs officials with MUB Customs procedures; and,

- inappropriate procedures regarding the treatment of factory rejects.

These are summarized below with recommendations for improvements and enhancements presented in the following sections.

6.98 **Extensive documentary requirements.** Currently at least twelve documents are involved in Customs procedures under the MUB. Because of the extensive amount of information and supporting documentation which is often required with these forms, preparing a large number of such forms can be a tedious, costly and time-consuming process. Without modification of these concepts, EPZ operations can similarly be subjected to requirements for multiple forms to be submitted at various stages of the EPZ operations such as import, transportation, entry into the EPZ, transfer from the EPZ and export. Because Customs processing time and shipping schedules are so critical to EPZ operations, as previously discussed, such extensive documentary requirements will seriously hamper the development of efficient EPZ operations.

6.99 **Cumbersome supervision and inspection procedures.** With as many as a dozen GOK agencies' representatives involved in importation procedures, considerable opportunity for delay and corruption exists. Physical inspection procedures are also cumbersome. In order to verify such information reported on the declarations, Customs conducts a physical examination of the merchandise

when it arrives at the port of importation or, in the case of inland international transportation, at the port of final destination. The physical examination requires that the merchandise be unloaded, if shipped in containers, and unpacked. In many cases, the unloading, unpacking and subsequent reloading creates situations where merchandise is damaged or lost through improper handling by inexperienced persons. This is particularly common at Mombasa port where cargo congestion, equipment handling deficiencies and personnel shortages combine to cause an environment unfavorable to safe examination of goods.

6.100 These problems are further aggravated by some Customs requirements that merchandise be examined twice; for example, for imports, once at the port of import when the merchandise arrives, and again at the factory site under the supervision of MUB Customs personnel; and similarly, for exports of temporary admission merchandise, once at the inland port before being loaded into containers at the shippers' premises, and again at the port of export before being loaded onto international vessels. Such situations obviously cause delays in merchandise shipments, but of equal importance, create extra opportunities for the merchandise to be lost or damaged through the additional unpacking and repacking of the inspection process.

6.101 **Prolonged Customs documentary processing times.** For a number of reasons, the time to process merchandise through Kenyan Customs procedures can be extensive -- often as long as two weeks and in some cases even longer. According to Customs personnel, such extensive processing time is attributable principally to a shortage of Customs personnel to process the documents; and also to improperly prepared documentation, requiring corrections and additional processing time. Again, because of the need to expedite EPZ operations, there is a need for the development of techniques and procedures which will help accelerate the processing of EPZ declarations through the Customs review channels.

e. Proposed Enhancements to Kenyan Customs Procedures to Meet EPZ Requirements

6.102 A Kenyan EPZ Customs regime can be developed by combining many existing procedures and practices into a single system that will provide operating personnel with familiar procedures but will contain modifications and enhancements to meet the unique requirements of zone operations. The following modifications are recommended for consideration:

- develop a single EPZ declaration form;
- provide single, on-site inspection capability for EPZ operators/users;
- assign inventory safekeeping and recordkeeping responsibilities to EPZ operators and users; and,
- develop enhanced enforcement techniques.

6.103 As discussed below, these recommendations use familiar concepts and procedures as a foundation to develop methods that will be attractive to EPZ users, while providing the GOK with necessary protective controls.

6.104 **Development of a single EPZ declaration.** In order to control zone operations and merchandise transfers, two documentary concepts are possible -- the use of existing forms with minor procedural modifications for EPZ operations; or, the design of a single form specifically intended for EPZ use.

6.105 The first method provides for the continued use of familiar documents and procedures, but as discussed previously can lead to the requirement for several different forms to be submitted at different stages of the EPZ operation. The suggested use of one specifically designed form -- an EPZ declaration -- is a more desirable method for Customs to control EPZ merchandise while allowing zone operators and users to have the flexibility necessary for successful zone operations. Such a form can be divided into several sections:

a. Merchandise release and EPZ entry -- (Zone entry). To authorize the release of merchandise from Customs custody at a port of arrival and, simultaneously, authorize transfer of the merchandise to the EPZ. This will be the official record of merchandise inventory in the zone and will establish the liability and responsibility of the zone operator or user.

b. Merchandise transferred from the zone and exported - (Zone Export). To authorize the transfer of merchandise from the zone to a port of exportation. It will relate to the first portion of the declaration by reference and will correspond to the merchandise previously entered into the zone.

c. Merchandise used, lost or destroyed in zone operations -- (Zone Usage). To account for zone merchandise destroyed, consumed in zone operations, and similar losses and authorize the reduction in accountable quantities of zone merchandise.

d. Zone merchandise entered for consumption -- (Zone Import). To authorize the transfers of EPZ merchandise into the Customs territory if allowable by the EPZ regime.

6.106 A single EPZ declaration can provide all the information needed by Customs while helping expedite the movement of merchandise to meet the needs of zone operators and users, which will be a dramatic improvement over the multiplicity of documentation currently required.

6.107 **Single, On-Site Inspection Requirements.** To help alleviate the disadvantages of duplicate inspection procedures and opportunities for lost and damaged merchandise, many Customs organizations have developed a successful procedure to have officers permanently available at EPZ locations on a 24-hour basis to process documentation and conduct inspections as goods are entered into the zone, or loaded for transfer out of the zone. Because of these on-site inspections, merchandise destined for EPZs or being exported from EPZs does not have to be inspected by Customs personnel at the port facilities.

6.108 Customs import and export procedures for EPZ merchandise are quite simple. EPZ-destined goods are clearly marked as such at their (foreign) port of exportation. Upon arrival at the Kenyan port of entry, and presentation of the appropriate documentation by the EPZ user, they are simply sealed by Customs at the port to indicate lawful entry and forwarded to the EPZ site, where they are opened under Customs supervision at the factory of the user. For authorization of exist of the finished products, the goods are inspected by the on-site Customs officer at the factory, documentation is checked, the goods are sealed, and they are passed directly through Customs at the port. Monitoring by Customs port officers is limited to verification that the seal is intact. This single inspection concept is critical to expediting the movement of zone merchandise and is generally considered mandatory to the operation of a successful EPZ program.

6.109 This procedure has several advantages to offer to both the zone operator/user and to Kenyan Customs. Obviously, it provides the zone with Customs personnel readily available to conduct Customs business in a timely manner -- an advantage to both the zone operator/user and Customs management. Additionally, Customs is relieved of the burden of inspecting merchandise at the port of arrival or the port of departure where freight congestion and a considerable inspection workload create difficult circumstances for both Customs and zone shippers.

6.110 **Computerized recordkeeping procedures**. The use of computerized operations -- either those maintained by the government, those maintained by zone operators/users, or both -- will provide a modern, efficient program to manage zone merchandise operations, particularly in cases where high volume and rapid merchandise turnover lead to voluminous recordkeeping burdens on both zone operators/users and government personnel. As previously discussed, significant government benefits can result by having zone operators/users use their own business computers to maintain information for government purposes where such capability exists.[11]

6.112 **Incentives for Customs officials**. It is recommended that increased incentives be provided to Customs officials to upgrade performance. Some EPZ locations have done this by setting up a special EPZ Customs corps that was separated from the regular force, with better facilities and higher remuneration. Other EPZ countries have instead set up a "Customs Fund," capitalized by contributions by private EPZ enterprises and EPZ owners, in order to provide increased benefits to Customs officials. The second approach is suggested for Kenya. This would provide officials working under EPZ with additional remuneration and benefits as an added incentive for improved efficiency and

---

[11] The recordkeeping requirements that are assigned to EPZ users under the regime are detailed in Annex D, Sections VII and VIII. Mandatory records generally include, quantity and description of goods entering the zone, stored, processed, wasted or discarded. Users are also responsible for accounting for the specific location of all materials at all times within their facilities. The EPZ implementing regulations also generally specify the frequency and content of formal reports to Customs that must be made by firms with EPZ status.

overtime work, and a disincentive for requesting undue favors from manufacturers. These additional benefits could then be built into the fees chargeable per year to EPZ manufacturers, or through contributions to the Customs Fund.

6.113 **Training for Customs officials in EPZ procedures**. Customs officials will definitely need more training and information on the application of procedures under special schedules such as MUB and EPZ. For example, the enactment of new regulations or a change in existing regulations should be accompanied by a seminar to explain the procedures to the officials. Such seminars would be more meaningful if they included both Customs officials and manufacturers, and allowed time to review current problems and shortcomings in the application of the procedures.

6.114 **Enhanced enforcement techniques**. The success of Customs operations depends on the use of enforcement procedures that punish offenders and encourage effective compliance with appropriate laws and regulations. Accordingly, an EPZ operation must also have a process of fines and penalties for violations as well as procedures for identifying violators. Some standard techniques include:

- Documentation. Customs can monitor, through computer information if available, EPZ merchandise movement by comparing zone transfer declarations with corresponding zone entry declaration to assure that inventory transfers and identities are properly reported and managed.

- Reporting. Zone operators/users can submit inventory status reports and reports of EPZ operations to provide Customs officials with information to review to ensure compliance with pertinent laws and regulations.

- Customs reviews of zone operator/user records. Customs personnel can assure that zone documentation is accurate through periodic reviews and comparisons of zone declarations with internal documentation maintained by zone operator/users such as inventory and operating records.

- Customs inventory examinations. Customs personnel can also conduct periodic physical verifications and examinations of zone inventory on-hand to determine the accuracy of information reported by zone operators/users.

- Assessment of duty and taxes. When missing zone merchandise is discovered, the zone operator/user must be required to pay the appropriate duty and import taxes as if the merchandise had been imported into the country for consumption, along with any applicable fines, as discussed below.

- Fines and penalties. Customs should have the authority to apply a system of fines and penalties against violators for merchandise shortages and other infractions of regulations. The EPZ regime should also provide for expulsion from the EPZ programs, in cases of severe violations by operators/users.

6.115 In our assessment, the Customs procedures system which is in place in Kenya is well organized and staffed, and can easily and feasibly oversee the operation of an EPZ scheme. That system could, however, only do so efficiently if improvements such as those outlined in this report are carried out. Improvements in employee training and processing procedures will not require an unreasonably large amount of resources, especially in comparison to the overall benefits that a more efficient system would yield. In fact, by removing duplication, reducing documentation and control procedures, and eliminating the proliferation of supervisory personnel, the utilization of GOK resources would be reduced while maximizing benefits. Improvements required for an EPZ scheme to work also include elimination of delays and laxity in the transfer of goods from port of entry to factory, and the reduction of delays and multiplicity of actions currently required in supervising the flow of material during processing.

6.116 Computerization of the Customs data collection and information retrieval system is an institutional goal that will benefit the EPZ program once it is implemented. At present, the Customs department has no "on-line" capacity for linking even district officers with the Central office, and with minimal equipment and a staff of only six people in the computer division, recordkeeping capabilities are restricted to the monitoring of international trade flows. To the extent that resources allow, the optimal computer system would provide Customs with an up-to-date account of the status of all merchandise entering the country under the EPZ regime, with information entered by the port officers and on-site officials. As discussed in Annex C, the Ministry of Finance has already allocated funds for the computerization of Customs, and contracted outside technical assistance for design of software systems. Such efforts should take into account the informational requirements associated with the proposed EPZ procedures in their implementation.

6.117 A major problem found during the research for this study was also the multiplicity of Customs officials handling the import or export documents associated with each shipment. Businessmen reported that considerable delay was caused by that factor alone -- that is, the process of documents moving from officer to officer, and the difficulties arising from unavailable personnel. As in the case of too many officers being involved in supervision, this system definitely needs correction. It is recommended that, apart from verification of the authenticity of the shipment at the port, as discussed in para. 6.108 only the on-site Customs officer is authorized to solicit all the required documents from each manufacturer under the EPZ regime. Such a system can be successful provided that both the official and the manufacturer are continuously vetted for ethical conduct.

6.118 The system of rewards and sanctions should be strengthened not only in respect to the operation of an EPZ or MUB scheme but in the approval system of the Customs administration system as a whole. In addition, the sanctions (and rewards) should be applied not only to public sector officials but also to those in the private sector. Businessmen who contravene Customs regulations under an EPZ regime should face very stiff penalties, including, in extreme cases, cancellation of business licenses, prosecution and fines. From the perspective of enforcement, material incentives such as those offered for increased efficiency could be provided to Customs officers that discover unlawful practices in the import/export activities of the EPZ firms. Similarly, manufacturers who

excel in business ethics and performance should receive special commendation and even preference in cases where prioritization is required.

VII. EPZ OWNERSHIP AND MANAGEMENT FRAMEWORK

7.01 This chapter presents alternatives for the overall configuration of a private sector-oriented free zone programs in Kenya which would both meet the requirements of its target sectors and capitalize on the country's comparative advantages. The discussion below first identifies the alternatives for ownership and management. After describing the attributes of successful free zone development groups, the chapter then outlines possible methods of attracting foreign developers or partners. Finally, the chapter then explores the facilities, services, and amenities that could prove attractive to potential free zone tenants.

A. ALTERNATIVE OWNERSHIP AND MANAGEMENT CONFIGURATIONS

7.02 There is a wide range of differing ownership configurations for free zones or industrial estate projects. At one extreme are purely public sector free zones such as those managed by the Development Bank of Mauritius. On the other extreme are purely private sector zones such as the Cartago Industrial Park/Free Zone in Costa Rica. There are also a number of different combinations that lie between these two ends of the spectrum. The key factor to a zone's success is not whether a zone is owned by the public, private, or mixed public/private sector but that zone management is sensitive to the needs and demands of zone users.

7.03 Nonetheless, the experience of EPZ-sponsoring countries indicates a preference among foreign investors for zones that are developed and managed on a completely private basis. This 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, for example, regularly choose to base their operations in private zones despite rental prices that are two to four times higher than public sector zones.

7.04 The willingness of zone users to pay higher rents is based on the perception that a private zone location yields a better long-term value and higher degree of service. In contrast to publicly owned and operated zones, private EPZ 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.

7.05 The general types of free zone ownership configurations can be described as follows:

- the contracting-out of management in a government-owned zone;

- joint equity ventures between the public and private sector. In 1959, for example, a North American private investor group teamed with a number of Bahamian institutions to establish Freeport -- a for-profit joint venture that includes an industrial park, resort, and residential facilities. The commitments by public sector

Previous Page Blank

partners need not be financial as government-owned real estate's imputed value can be translated into equity.

- long-term lease of government-owned land and facilities to the private sector. In the Special Economic Zones of the People's Republic of China, leases are granted for 50-70 years; a similar policy is followed in Hong Kong where construction has been done by private developers who have purchased long-term land leases from the government.

- "build-operate-transfer" (BOT) agreements under which a private investor develops and manages a zone 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. This type of arrangement was first utilized in 1969 by Gulf + Western in the Dominican Republic, and more recently in Turkey, where the Bechtel Corporation initiated a $220 million free zone/port development project.[1]

7.06 In any of these partnership arrangements, private investors will need adequate guarantees of authority and autonomy. While having public-sector involvement in a project can be seen by some investors as ensuring that the government will "be on their side," it also can create a situation where the government has the means to meddle in management or otherwise introduce the types of influences which have constrained wholly public sector projects.

B. ATTRIBUTES OF SUCCESSFUL DEVELOPMENT GROUPS

7.07 As seen above, successful EPZs have been developed and operated by a wide variety of groups, both public and private sector. Along with adequate infrastructure, inexpensive labor, and a supportive legislative/regulatory regime, the strength of the management team is essential to the success of a free zone. Successful free zones, whether non-profit or for-profit, are characterized by their long-range planning acumen and responsiveness to the needs of tenants. The abilities required in developing and managing a free zone project over the long-run include:

- **Real Estate Development Experience**. Many free zone developers have had prior experience in the planning, construction, operations, and marketing of real estate projects. At their most basic level, EPZs are a specialized form of industrial real estate development. Successful private developers, such as Grupo Zeta (Cartago) in Costa Rica, often have substantial interest in construction firms. This allows them to reduce development costs, while also keeping the

---

[1] In recent months, Bechtel has been stymied in concluding agreements for its BOT project, and a Japanese consortium has emerged to undertake a similar BOT zone venture in the country.

incremental income from the construction side of zone facilities, as well as capitalizing on economies of scale within related groups.

- **Marketing Expertise.** EPZ development must coordinate the zone's physical plan with its marketing strategy. The promotional focus for simple assembly operations, complex manufacturing, and data entry office parks require dissimilar methods. The marketing of free zones requires a sophisticated understanding of international industrial activity and global trade patterns, an ability to deal on an equal basis with foreign corporations, and an appreciation of the concerns of international businessmen. Additionally, strong ties to the local business community will be an asset.

- **Financial Expertise.** Free zone projects are large, long-term investments that can typically cost between $10-25 million. They require substantial financial expertise in their planning and execution to ensure adequate returns. Along with the long-term strategic financial planning, knowledge of finance is useful in structuring loans, bonds, or stock arrangements, as well as making use of debt-equity swaps and other innovative financing techniques. In addition to financial expertise, significant financial resources are also required for development. Such financial resources may be provided by private developers, or through funding by multi-lateral donors or development banks.

7.08 It is indeed rare that the various resources and abilities required for free zone development will be found within a single company. Some of the large, diversified industrial/financial groups in Kenya may provide an exception in this regard, as they are comparable to the diversified groups which have successfully undertaken in countries such as the Dominican Republic. Less diversified firms may find it advantageous, however, to form consortia with other firms.

7.09 Another alternative in this regard is to seek out associations with foreign firms which can round out the developer group's expertise. This may be particularly relevant in terms of both the needed marketing and financial expertise.

7.10 The role of foreign investment in developing free zones has been important in a number of countries. As discussed above, foreign investors played leading roles in the establishment of Freeport in the Bahamas, La Romana in the Dominican Republic, and the Yumurtalik zone in Turkey. Gulf + Western, Bechtel, Trammel Crow, and other foreign investors have shown a willingness not only to design the project proposal, but to construct and finance the zones as well. As part of the now-moribund Yumurtalik, Turkey project, Bechtel was willing to construct the necessary infrastructure at no cost to the Turkish government.

7.11 Attracting foreign partners as investors can be a difficult endeavor, however, due to the risks associated with the large investments in fixed assets and the long payback periods. While some U.S. based development groups have undertaken foreign investments in free zones and industrial parks, this has often been the result of a long association with the country or some other involvement.

There are a number of methods that can be utilized in attracting foreign developers or partners. The most successful strategies are as follows:

Attend overseas conferences. Numerous conferences are conducted by large U.S. development groups. The most prominent organization is the National Association of Office and Industrial Parks. At these meetings, developers convene not only to learn the latest techniques in park construction, financing, and marketing but also to seek out future potential projects.

Conduct a conference in Kenya. In 1988, the Dominican Republic's IPC held the "Crossroads" conference to link Dominican zone investors with potential North American partners -- primarily among real estate and construction firms. A number of initiatives were started due to the conference, including a private infrastructure project and a zone partnership between a Dominican parastatal and a U.S. investment group. A similar conference could be held in Kenya with potential investors from the Far East and Western Europe.

Seek out telecommunication companies. Telecommunications companies are becoming increasingly cognizant of the large potential market in information processing via teleports. CODETEL, a Dominican subsidiary of GTE, is part owner of the Las Americas and San Isidro Free Zones in the Dominican Republic. In addition, CODETEL's "infoport" is connected to the San Isidro Free Zone via fiber optic lines and there are plans to link it with other major zones at a later date. Similarly, AT&T and Cable & Wireless are partners with the Jamaican government in the Montego Bay Free Zone; the government owns the zone and the two firms own the "Digiport." This teleport facility has allowed Jamaica to take a leading role in offshore information services processing in the Caribbean. In addition, other national telecommunications firms such as that of Taiwan have shown substantial interest in joint partnerships in free zones with teleport facilities. While this may be of marginal relevance at this stage of free zone development in Kenya, it may be relevant in the future.

Seek investment from foreign governments. In addition to receiving loans or grants from foreign governments or donor organizations, it is also possible to explore direct investment from foreign governments. Taiwan and South Korea have been considering the establishment of a free zone in Central America for a few years which would allow their own countries' firms special immigration status and better access to developed country markets. It has recently been reported that the Taiwanese Government is investing $40 million in the Colon Free Zone in Panama to expand its EPZ facilities.

Investigate investment from foreign firms already in Kenya. Foreign companies with long, successful histories in a country are perhaps the most likely of foreign investors to develop -- whether jointly or alone -- a new zone. Gulf + Western held large sugar plantation holdings for decades before it built La Romana; similarly, United Brands had extensive banana holdings before it invested in a small palm oil bio-

engineering plant in Coto Sur, Costa Rica. There are numerous large companies with long-standing relations with Kenya that could be approached for zone projects; one of these may be interested in becoming an anchor tenant, thereby lending prestige and a visibility to the EPZ in its earliest stages.

7.12 These efforts will ideally involve a substantial commitment by the government as well as by other institutions. Indeed, efforts undertaken by developers on their own are unlikely to be successful without this broad base of support.

C. EPZ MANAGEMENT

7.13 This section presents the suggested organizational structure and functional responsibilities best suited to the realization of the project's potential. The proposed approach represents a flexible, cost-effective and practical method for developing an effective management organization. It is purposely intended to maintain a small and efficient staffing structure, relying wherever possible on contracting services rather than building up large, in-house staffs.

7.14 Especially during the start-up and early operating phase of the project, organizational complexity should be avoided. To this end, the initial organizational structure and staffing plan suggested is minimal, concentrating all essential management and operating functions in a "chief executive officer" -- the General Manager, assisted by an Office Manager and an Engineer.

7.15 **General Manager.** The ongoing responsibilities of the General Manager include the following:

- Staffing and personnel supervision; recommend staff compensation/performance incentives;
- Long-term development planning;
- Annual budget preparation and monitoring of results;
- Liaison with related governmental agencies;
- Essential marketing and promotional activities;
- Tenant screening and relations;
- Support for zone firms on investment applications;
- Establishing working linkages between the EPZ and local training institutions to develop an adequate supply of skilled personnel for zone tenants;
- In cooperation with other relevant agencies, continuing efforts to improve external infrastructure such as transport facilities (for both goods and personnel) power, water, telecommunications and so forth;
- Coordination and arrangements for zone services;
- Prepare final lease/purchase agreements/covenants including:
  - architectural controls (setbacks, building specifications, landscaping, etc.)
  - responsibilities for repair and maintenance waste/effluent disposal
  - signage

- storage of materials
- rental rate escalation
- alienation of premises
- termination of lease

7.16 The careful selection of the General Manager is essential to the ultimate success of the project. This individual should ideally have prior experience in business management, knowledge of accounting and finance, familiarity with the social and physical infrastructure needs of industrial operations, and a proven capacity to successfully operate a profit-oriented business initiative.

7.17 The General Manager will be responsible for overseeing the operations of other professional staff, consisting of an Office Manager and an Engineer. It is expected that the General Manager will perform many of the duties of a promotion or marketing representative: with adequate support from qualified professionals in business/financial management and engineering, he should be able to accomplish this without having to establish a separate position. It may be the case that a promotion officer will be necessary as a full time position. Here too, however, this arrangement could be handled on a retainer basis with outside individuals or firms.

7.18 **Office Manager.** The Office Manager will provide the internal financial and general management support services necessary for the functioning of the zone, including maintenance of payables and receivables, personnel records, and management information systems. The ongoing responsibilities will include:

- setting up the accounting system for the zone and maintaining accurate financial records;
- providing assistance to the zone management in verifying the accuracy of tenant application information;
- maintaining up-to-date rent rolls, billing tenants and collecting rents;
- providing periodic occupancy reports to zone management;
- furnishing actual versus budgeted operating statements to the zone management;
- staffing and supervision of the zone security force;
- making disbursements, including taxes, insurance, payroll,service contracts, and payments for Government services.

7.19 Preferably, the Office Manager will be trained in financial accounting with some experience in similar positions either in private business or public administration, or both. Security personnel would be hired as needed to maintain 24-hour patrol of the zone facilities, and provide entry/exit control. This important service can also be provided by a security firm on a contract. In addition, a secretary would also be hired as support staff.

7.20 **Engineer.** The General Manager would also be responsible for selecting a qualified engineer to take on the role of supervising the physical development and maintenance of the zone. The Engineer holds an important managerial position in the zone. The actual maintenance and other services can be effectively contracted out, instead of building an in-house staff, which has generally not proven to be financially sound in the long-term. This is a cost saving measure

that is not uncommon in well-managed free zones. The responsibilities of the Engineer will include property development and management, including preparing physical plans, overseeing the zone development program, and managing facilities upkeep. Working with the General Manager, the Department will refine cost estimates for development projects, prepare civil works documents for tender; and recommend contractors for ongoing and proposed project execution. Additional functions include:

- maintaining technical reference files including architectural/engineering drawings, specifications, manufacturers' catalogues and instructions on maintenance and operations;
- establishing basic operating procedures and drafting service contracts in procuring building and grounds maintenance services, electrical and HVAC systems, security systems, waste disposal;
- developing preventive maintenance schedules and maintaining an adequate supply of spare parts for estate buildings and equipment;
- supervising the initial phases of estate property development: placement of signage and building directories, installation of communications equipment, parking and freight and cargo facilities, letting of service contracts for waste disposal, janitorial services and infrastructure expansion;
- establishing guidelines for tenant modifications/ improvements of estate buildings and monitoring all construction activity;
- periodic inspection of all estate infrastructure for repair and maintenance needs.

7.21 **Contract Management.** Some free zone developers may prefer to contract out all aspects of the EPZ's management. Normally, a property management company takes as compensation a fixed percentage of the gross monthly income. This gives management the incentive to keep the property fully occupied at the highest rental rate obtainable. The management contract should spell out the duties and obligations of the management over an agreed period of time. This time period should be at least a year, but short enough to allow the developer to end the contract, should the contract management team turn out to be unsatisfactory. The management group should be prevented from handling the developer's funds for improvements and repairs, and instead should invoice the developer for these amounts. The management company's authority to make any improvements or repairs should be limited to those under a fixed amount; otherwise, prior written approval should be required. Finally, a regular periodic reporting procedure on the status of the property and its tenants should be submitted to the developer.

7.22 **Board of Directors.** As with any corporation, the composition of the EPZ's Board of Directors should clearly include existing equity participants. In addition, it is strongly recommended that the developer of the EPZ invite Kenyan and foreign internationally-recognized individuals to serve in an advisory capacity. The input of these individuals will be valuable and the insights they can provide will greatly assist zone development. The developer may also invite the IPC and other government and non-government institutions to participate in an advisory capacity. This will greatly further coordination between all bodies. If leading academic, economic and other international institutions and

individuals affiliate themselves with the project, the credibility and promotional appeal of the zone will be greatly enhanced.

7.23 The resulting organization is shown on the chart on the following page. This simple management organization can be enhanced over time if the zone grows rapidly, or if it is decided to augment the staff by the addition of more professional staff in a promotional capacity. It is likely that, as the EPZ is fully developed, additional support staff, to include an additional secretary and/or administrative assistant, will be necessary.

D. PRICING OF EPZ FACTORY SPACE AND SERVICES

1. Objectives of a Sound Pricing Strategy

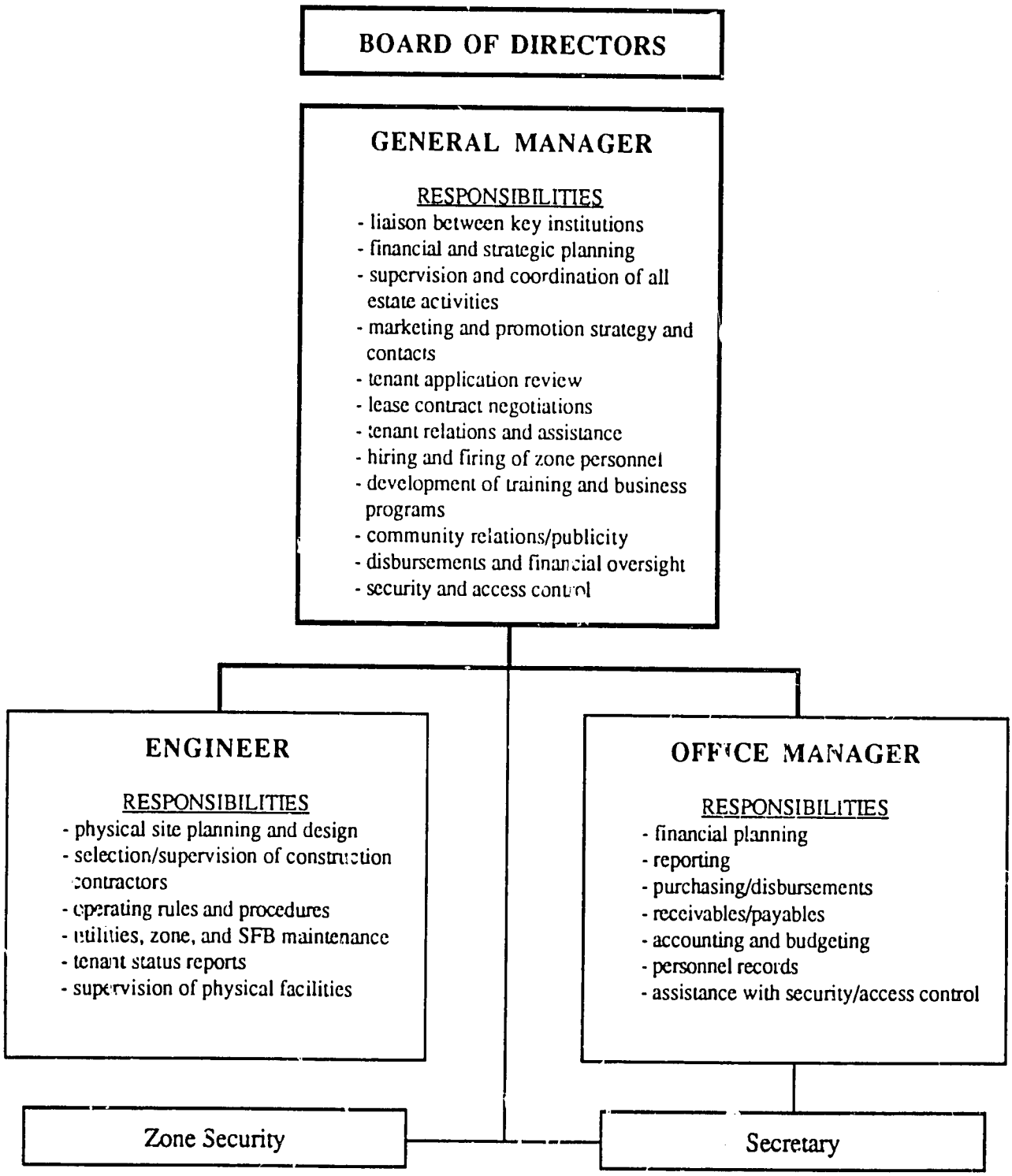
7.24 The pricing of free zone facilities and services is a controversial issue that is at the heart of successful zone development. On the one hand, rental rates charged by most public sector free zones have been highly subsidized and priced well below market (economic) rates. The reasoning for this is that the financial losses accrued are offset by incremental economic benefits over the long term. Private sector zone operators, on the other hand, are interested in maximizing rental revenues and earning a reasonable return on capital invested. The pricing of SFB space in Kenya should consider the following:

- the rent cannot be so high as to deter investors from establishing operations -- even though rent in the total cost of production is minimal (usually less than 5 percent), zone users resist paying higher rents, if not offset by other benefits;
- the rent charged must be competitive with competing free zones in the region, principally Mauritius, Togo, and Cameroon; and
- the rental rate charged must be sufficient to not only cover operating costs and debt service requirements, but must also generate a reasonable financial return.

7.25 From a financial perspective, full cost recovery and generation of a reasonable return is the primary objective of project development. An EPZ project should not be undertaken if profitable results cannot be demonstrated within 8 or at the most 10 years after the initial construction phase. The Internal Rate of Return (IRR) for successful projects over a 20 year period -- a reasonable interval for purposes of financial analysis, corresponding to the minimum acceptable depreciation period for buildings -- should be at least equal to the opportunity cost of capital (in most countries, that would be more or less the prime interest rate paid to commercial banks by large, financially solid businesses). The rental rate is only the revenue side of the project, and profitability is equally a function of costs.

7.26 The determination of base rental rates for EPZ factory space directly follows from the objective of full cost recovery. Experience worldwide has shown that given a "reasonable" debt/equity ratio, debt service charges and operating costs, financial profitability is achieved if each rentable square meter of factory space can generate at least 15 percent per annum of the "all-in" cost

FIGURE 7-1
SUGGESTED ORGANIZATIONAL STRUCTURE FOR EPZ MANAGEMENT



to construct that square meter as gross revenue. Rental rates that are set below the 15 percent threshold are generally unable to generate a positive return.

7.27 For purposes of comparative analysis, the current rates prevailing in a number of EPZs are shown in Table 7-1. As can be seen, the rates for public-sector zones are consistently lower than private zones, with the exception of Jamaica. Comparisons made between zone locations on the basis of rental rates alone, however, can be misleading. Many zones sell SFBs as well as rent them; in other zones, rental rates cover only the cost of the land and investors must build their own buildings. As seen in the table, rental rates for land without factory buildings in Senegal, Togo, and Sri Lanka are quite low. A Kenyan EPZ with a similar arrangement would have to be priced relative to these zones to be competitive. Finally, zones differ greatly in the number and types of services included in the base rental rates. Many free zones are also currently able to charge users a premium above base rental rates for zone space.

2. Purchasing Option

7.28 The option of purchasing land in the EPZ facility is often attractive to many firms, and should be provided for both within the overall legal EPZ framework and as an alternative offered by zone management. Likewise, allowance should be made for firms wishing to construct their own facilities, especially in the case of agro-industry or electronics industries which often have customized requirements.

7.29 Because much of the initial demand for free zone space in Kenya is expected to derive from local manufacturers, this may fuel a large amount of interest in the purchasing, rather than renting, of free zone space. In a country such as Costa Rica, EPZ occupants prefer to buy space because of their long-term commitment to the country, as well as because of a financial package that encourages purchasing over renting. In determining the price of leases with options to purchase, it is advisable to set annual rentals 10 to 15 percent higher above the straight rental level. Generally, the firm is required to wait for 3 to 5 years before it can exercise its option. At the time of exercising the option, the value of the building should be the market value, as determined by independent appraisal, the cost of replacement, or income approach. This amount should be discounted according to an agreed value. One possibility is to have the option price be market price minus depreciation. Another is to have a portion of the rent paid credited to the final purchase price. In these cases, an administration fee, normally assessed on a per unit basis, is also collected to cover services and operating amenities provided by the zone which would otherwise be included in the rent.

E. FACILITIES AND SITE REQUIREMENTS

7.30 As identified in Chapter 4, the likely primary users of a free zone facility in Kenya are light manufacturing enterprises such as apparel manufacturing firms and leather shoe assembly firms. The needs of such firms in terms of the optimal locational attributes, facilities, and services of a Kenyan EPZ are straightforward. The requisites of the high-potential industry

TABLE 7-1
COMPARATIVE SFB RENTAL RATES, 1989
(US$, sq.m./month)

PUBLIC SECTOR FREE ZONES	
MAURITIUS	
Media Estates	$2.49
LIBERIA	$1.06
TAIWAN	
Hsin-Chu Science-based Industrial Park	$2.07
COSTA RICA	
Moin	$0.90
JAMAICA	
Kingston	$4.40
Montego Bay	$3.14
SENEGAL *	**$0.09**
TOGO *	**$0.05**
SRI LANKA *	**$0.03**
PRIVATE SECTOR FREE ZONES	
COSTA RICA	
Alajuela	$2.70
Cartago	$2.70
DOMINICAN REPUBLIC	
La Romana	$1.12
La Romana II	$2.36
San Cristobal	$3.59
San Isidro	$4.49
PRIVATE, NON-PROFIT ZONES	
DOMINICAN REPUBLIC	
Santiago	$1.18
GUATEMALA	
Grupo Zeta	$2.00

---

* Includes ground rent only; investors must provide own SFBs.

Source: TSG data compiled in 1989

sectors clearly point out the importance of a locating an EPZ where there is ready access to a suitable labor pool and adequate infrastructure. Solid transportation linkages for workers and cargo (both domestic and international) are also of prime consideration to potential EPZ users. Finally, a potential site's distance from business support services and proximity of housing and amenities for management and technical personnel should also be considered.

7.31 The fortunes of the first EPZ designated and developed in a country can have a substantial and lasting impact on the pace of EPZ development and the overall, long-term performance of the national program. By carefully selecting the first EPZ site to be developed, the opportunity exists to create substantial momentum not only for investment in the project by foreign and domestic industries, but also for the initiation of other, privately owned and operated EPZ facilities. Conversely, if the "pilot project" is widely regarded as a failure, perceptions regarding the EPZ program and the overall investment climate in Kenya are certain to suffer. For this reason, the locations presently under consideration should be carefully assessed and "market tested" prior to embarking on the detailed and costly engineering studies associated with pre-investment analyses.

7.32 In order for a Kenyan export processing zone to be competitive with other zone locations and to attract foreign investment, it is necessary for it to be "market driven." The target firms that, in aggregate, form the market for a Kenyan EPZ, evidence some or all of the following characteristics, at least in the short-term:

- firms in typical light manufacturing sectors will probably be engaged in the production of "lower end" goods utilizing standardized production techniques and processes, with lower value products and simple operations;
- EPZ investment by local firms will range across all sectors and sizes;
- foreign investment will probably be characterized by small- or medium-sized East Asian firms, and to a lesser extent, U.S. and European investment in the form of subcontracting operations;
- all firms will be involved in processes that place a premium on a trainable and low-cost workforce; and
- zone users will typically be interested in ready access to standard factory shells for light manufacturing activities.

7.33 There has been a clear preference worldwide for zones with fully developed factory shells, complete with infrastructural connections; as seen in Chapter 2, the lack of such factory shells has been a major factor behind the poor performance of Senegal's EPZ program. The Kenyan EPZ program can increase its competitiveness through the provision of specific programs and facilities that provide for immediate occupancy by interested firms and defray some of the initial costs of commencing operations.

7.34 Based on the analysis of offshore manufacturing trends in Chapter 4, a Kenyan free zone should be characterized by the following physical characteristics:

- the size of the buildings should be appropriate for typical light manufacturing activities;
- the shells should be built according to a standardized design;
- the pace of construction should be kept slightly ahead of effective demand so that one or two factory buildings are available for immediate occupancy at all times;
- no extraordinary structural features are required -- simple, cost-effective modifications can be made to standard factory buildings (SFBs) for an enhanced appearance;
- a full range of on-site infrastructure and basic services -- power, water, sewerage, and telecommunications -- should be provided;
- climate controlled buildings are not needed for zones in the Nairobi area -- although a zone located in a hotter location may need air conditioning, unusually high demands for power and water are not anticipated;
- on-site facilities for Customs should be available; and
- the EPZ site should not be smaller than 30 hectares (74 acres) in size.

7.35 In order to meet the diverse needs of all potential users, the buildings should be of a standard modular design, with 2000 sq.m. of "under-roof" space. This allows for easy partitioning and subdivision into 1,000 sq.m. modules for smaller firms, and doubling for larger industries. This type of building maximizes the EPZ's flexibility in meeting the needs of both small Kenyan and larger overseas firms. Most SFBs are constructed with 5 to 5.5 meters (16 to 18 feet) clear to the eave, with a corresponding peak of the roof at approximately 7 meters (23 feet). These dimensions allow for the installation of a second floor, air conditioning, dry wall, and carpeting, if so desired; although installation of a second floor adds to the project's cost, and the installation of features such as air conditioning or carpeting are normally the responsibility of the tenant firm. Special installations can be added as the need arises, including refrigerated areas for produce storage and packaging, air conditioning, special clean rooms for electronic assembly, etc.

7.36 The EPZ site can be adapted to a variety of building plot layouts. The master plan should provide for a spacious, aesthetically attractive layout that is also cost-effective. The site must not be developed so luxuriously as to jeopardize the project's financial viability. Most free zones and industrial parks around the world assume that about 25 percent of the total site area is dedicated to the development of common facilities such as roads, easements, and administration and service areas, and green areas. The remaining 75 percent of site acreage comprises the manufacturing plots.

7.37 The proposed design should also follow the natural contours of the land to maximize aesthetic appeal. A premium should be placed on creating an attractive environment including extensive landscaping and provision of green areas; cosmetic improvements to "beautify" the proposed SFB design; and the development of a first-class, attractive signage system for the zone.

7.38 To isolate the activities and movement of production inputs in accordance with general Customs procedures in duty-free area, the EPZ master plan should consider security needs as warranted by local conditions and authorities.

Typical EPZs also include high intensity lighting for the grounds, and an eight foot fence around the perimeter of the zone. Physical divisions between individual plots are not usually necessary. Security experts should be consulted for comprehensive plans.

F. SUPPORT SERVICES AND AMENITIES

7.39 In addition to physical facility requirements, many companies frequently seek out specific support services and amenities. The range of support services offered by many free zones worldwide is extensive and varies by market and user; the offering of the following services constitutes the range of options which may be attractive:

- assistance with complying with government regulations;
- assistance with labor hiring through the provision of a job bank;
- security;
- commercial banking including debt finance at reasonable cost, loan guarantees, equity investment funds;
- retail banking for the zone workforce;
- "incubator services" including provision of shared business facilities, temporary office services, services to assist new businesses;
- child-care facilities and services;
- medical clinic;
- on-site cafeterias;
- on-site dry goods store with low mark-up;
- strategic links and cooperative arrangements with technical training institutions;
- linkages with computer repair and other equipment vendors;
- specialized housing for workers and expatriate management;
- worker transportation;
- shelter plans (a form of joint venture in which enable offshore manufacturers link up with local manufacturers, who bear responsibility for obtaining inputs, hiring labor, etc.);
- conference centers and meeting rooms;
- product display areas;
- recreational facilities; and
- purchasing, or leasing with an option to purchase, zone plots and buildings.

7.40 As competition among zones has risen, they have increasingly begun to offer many of the above services and amenities as part of a standard package to differentiate their zones and enhance user-appeal. As free zones have developed and advanced on the product life cycle, the offering of a wider range of services has been an obvious strategy at creating market segmentation. However, the true "incentive value" of these services varies from industry to industry. Non-price competition of this kind is gaining importance as zones multiply and users become more sophisticated in their location selection criteria.

7.41 The above list of services is presented as a comprehensive guide for project development, rather than a recommended set of services. Apart from on-

site Customs facilities, few auxiliary or business services are critically important, particularly in the initial stages of development. A Kenyan free zone should be selective about the types of support services and amenities to be offered. The service package offered must achieve a realistic balance between meeting the requirements of target sectors, and doing so in a cost-effective manner. This is particularly the case because initial users of the zone will likely be Kenyan firms more constrained by cost factors, and may not be willing to pay for services, either on a fee for services basis or as an invisible component in the rental charges.

7.42 Of major concern to small- and medium-sized firms is the ease of establishing in a free zone location. Unlike larger multinational corporations where production location decisions are the outcome of a time-consuming, complex evaluation of competitive locations, smaller firms tend to make investment decisions quickly, and establish operations soon after the site visit. As such, a Kenyan EPZ can distance itself from competing locations to the extent that it can provide special programs and facilities that allow smaller firms to establish operations rapidly, and defray some of the initial costs of operation. Very often, a firm in need of rapid start-up can be captured merely by having a factory shell ready for occupancy. Similarly, the existence within the EPZ of a "one-stop-shop" to expedite investment approvals would also be very attractive to potential investors.

7.43 Other support services and amenities such as on-site cafeterias, recreational facilities, and the like, can be offered as demand warrants. It is important, however, that the services envisaged be incorporated into the overall conceptual design of the zone from the start. The importance of planning for the eventual provision of additional services and amenities from the initial stages of EPZ development cannot be overestimated. For example, in its physical planning, the zone should allocate a suitable site for a medical clinic even if it is not built for some years. Promotional materials should clearly define all services to be offered in the future. The actual provision of the services, of course, should be phased in gradually as demand warrants. This is not to say that the developer of the zone need actually provide the envisaged services himself. Often, the services will be viable to the extent that they can be run as successful concessions by local service providers; the services clearly ought to be provided on a "self-liquidating basis" -- either by funding them through additional fees and charges to zone users or franchised to independent local operators. The role of the zone is generally in the coordination of the services, and in the provision of facilities. The latter can be done in some cases on a revenue producing basis, as for example in charging rental fees to banks and other commercial establishments.

7.44 Local service providers could provide a number of basic services within the EPZ. These include security, cafeterias, worker transportation, health care/clinic services, banking, and international courier services. These involve only a minimal allocation of facilities, and by allowing the private provision of these services the EPZ is able to avoid incurring these costs. This is especially true for support services such as international courier services and banks.

7.45 Provision of training, however, could require more substantial facilities, as well as an ongoing association with one of Kenya's many technical training schools. Two EPZs where this type of linkage has been very successfully done include the Cartago free zone in Costa Rica and the industrial estates program of Barbados. The former has a linkage with the national training program to cater to zone user needs; the latter has established a highly successful Garments Training Institute within one of the island's industrial estates. Firms coming to the zone can arrange to have workers recruited and trained by participating institutions, if appropriate, on their own equipment.

7.46 On a more general level, an on-site training institution could offer general courses to prospective employees in fields such as industrial sewing. Firms can be expected to support such an effort with donations of equipment and other supplies. More specialized technical training, such as in industrial equipment maintenance and repair, will also be valuable on a smaller scale. Special linkages with local universities provide users access to graduates with needed skills, and offer prospects for on-going skills-enhancement and "credentialling" for existing employees.

7.47 Finally, some of the more progressive EPZ programs worldwide have taken steps (on both a national and project-specific level) to foster supply relationships between the zones and domestic business. An EPZ development group might also want to introduce similar measures to facilitate the establishment of sourcing and subcontracting linkages between EPZ firms and local industry.

7.48 Pricing strategy, as it relates to support services, is subject to great misunderstanding as it is generally not clear what services are included in the base SFB rental rate and what services are incremental. The following services are normally included in the base rental rate: perimeter security; full provision of electricity, water, telecommunications, and other utility connections; liquid and solid waste disposal; grounds and public areas maintenance; external building maintenance; and landscaping. Typically, zone users are solely responsible for payment of all utilities (telephone, water, gas, electricity, etc.) used or consumed on the leased space, and any alterations in terms of special facilities or utility installations required.

7.49 All other services, therefore, can be charged for separately. In most successful free zones, services are franchised out to independent local operators. As discussed above, it is often not cost-effective for the zone to provide itself such services as cafeterias, daycare, and medical services. While the local businesses providing these services can be expected to pay rent for facilities provided by the zone, it is not likely that they will make significant contributions to zone revenue in a direct sense.

C. RECOMMENDATIONS FOR KENYAN EPZ DEVELOPMENT

7.50 The above discussion has illustrated that far from being identically organized entities, EPZs around the world vary substantially in terms of their ownership, management configurations, services provided, and rental rates, among other factors. Based on this overview of the diverse forms of EPZ ownership and management frameworks, and combined with the TSG study team's interviews and

analysis of the factors unique to Kenya, it is possible to make a number of recommendations for a Kenyan EPZ.

7.51 In light of the different types of EPZ development that have been successfully employed throughout the developing world, it is highly recommended that Kenya's EPZ law allow for all forms of EPZ development, ranging from public ownership, to public/private forms, to BOT agreements. It is important that the Kenyan law not foreclose in advance any possible form of development or deter any possible developers.

7.52 No matter what type of EPZ management configuration is ultimately chosen, it is important that, at a minimum, the EPZ be managed on a cost recovery basis, if not on a for-profit basis. The principle of cost recovery is absolutely necessary whether the EPZ be run as a private, public, or mixed organization. Public sector zones have operated successfully in a number of countries such as Taiwan and South Korea, but the underlying cause of their success has been that they have been operated on a business-like basis. EPZs which have subsidized their rental rates to attract investors in the short-run have ultimately lost money and have earned insufficient revenues to adequately provide services and maintenance in the long-run. If, as envisioned under one scenario of EPZ development process in Kenya, the GOK undertakes the construction of EPZ infrastructure, this cost should be reflected in EPZ rental rates and recovered by the GOK.

7.53 It is also recommended that the GOK's EPZ legislation allow a private developer to select the EPZ site. In the final analysis, private developers who are placing their capital at risk will be the most effective arbiter of the most viable site for successful EPZ development. Likewise, private developers who are risking their own capital are unlikely to be willing to invest in a pre-selected EPZ site.

7.54 The preliminary analysis in Chapter 3 has shown that, contrary to the belief of many GOK officials and members of the private sector, neither the cost of industrial land nor construction costs are prohibitively expensive in Kenya relative to other EPZ sites. Thus, the GOK should consider allowing the purchase of industrial land for an EPZ site by a developer.

7.55 Should the government prefer to retain ownership of the site, however, as is the case in many EPZs, or if the GOK believes that land speculation will interfere with the site selection process, then government land should be made available on long-term lease in order to ensure sufficient financial returns on the project. The length of leases to be offered on government properties could range anywhere from 20 (normally a minimum for successful development) to 99 years or higher. In light of the fact that 30-year leases are already the standard minimum for government-leased land, it is suggested this should be specified as a minimum period. Leases should be renewable on mutually agreed terms. The renewal of these leases, for both public and private land, can be allowed if it is agreeable to both parties.

7.56 The Kenyan EPZ law should also clarify the status of improvements made to government land by an EPZ developer or EPZ firms. Currently, such improvements become GOK property without payment of compensation once the lease is over. Even

if the GOK provides infrastructure on the site, a developer (or EPZ firms, depending on the final configuration of the project) will make a considerable investment in buildings. As it now stands this provision may deter potential developers and should be amended; alternatively, its negative effects on investors could be offset by setting minimum lease terms at 99-years, such as exist in Hong Kong.

7.57 The lease should clearly state that the property is to be used for an EPZ. The government may wish to make the lease of state property and continued EPZ designation contingent upon initiation of construction within a defined period, for example, one year[2]. If the developer does not begin substantial construction within that time, the project would lose its EPZ designation and the government could then seek out other potential developers. The objective of this provision is to ensure that EPZ development occurs at a timely pace: it prevents developers from keeping potentially valuable EPZ sites off the market by providing a mechanism whereby other developers can be granted access to the land or given EPZ designation. As discussed in Chapter 3, however, it is important that the development timetable not be too strict so as to force development too rapidly; development in the absence of sufficient tenants undermines the financial stability of the project. In addition, procedures and criteria should be established for the granting of time extensions should there be extenuating circumstances.

7.58 There appears to be little demand at this initial stage for specialized facilities within a Kenyan EPZ. A local Customs presence is clearly necessary for the efficient operation of an EPZ, but in order to control costs, it is advised that the EPZ should initially offer only basic services; bearing in mind, of course, that provisions for additional services or facilities should be included in the original plans to enable their future construction on a "as-needed" basis. The GOK should strongly consider, however, including among the facilities offered in the EPZ two key services. These would be an on-site office of the EPZ regulatory body that has the authority to act as a "one-stop-shop" investment authority, as well as an office or individual with responsibility for liaising between local suppliers and EPZ firms. In particular, establishment of a on-site one-stop-shop would greatly facilitate investment in the EPZ by minimizing the amount of time and distance that investors would have to expend to receive investment approval. Prospective investors to the site would also have on-hand all the necessary information needed to invest in Kenya.

7.59 The liaison between local suppliers and EPZ firms could ideally be a task assigned to zone management. There are many firms in Kenya which are not large or sophisticated enough to produce for export, but which produce inputs that can be used by EPZ companies. It is recommended that the EPZ management be

---

[2] As discussed in Chapter 3, a similar clause already exists in government lease agreements. Moreover, such a provision is consistent with the requirement (as discussed in Chapter 6) that applicants for EPZ designation submit a construction schedule; a provision requiring development within a certain period thus enables the EPZA to ensure that EPZ developers adhere to the construction schedule submitted with their application.

encouraged to foster these backward linkages to the local economy. Doing so will both extend more widely throughout Kenya the economic benefits of the EPZ, and will assist EPZ firms by providing them with easily accessible and reliable sources of inputs.

VIII. IMPLEMENTATION PLAN

8.01 The discussion on the preceding pages has outlined an ambitious program for the Government of Kenya in support of EPZ development. The contents and structure of the EPZ regime, as recommended, constitute a major new policy initiative that will build upon the efforts already undertaken by the GOK toward economic liberalization. In order to establish the requisite legislative and institutional framework in support of the program, a concerted effort will be required by both the public and private sectors. The purpose of this chapter is to identify the key actions that should be taken over the coming months toward the establishment of a competitive and workable EPZ program in Kenya.

A. ORGANIZATION OF THE EPZ WORKING GROUP

8.02 The analysis and recommendations contained in this report together constitute a suitable basis from which the Government of Kenya, and the Ministry of Finance in particular, can formulate the optimal structure and content of the EPZ regime. It is highly recommended that open discussion of the report findings be encouraged among GOK officials and private sector organizations and individuals. The GOK has already formed an inter-ministerial EPZ committee, comprised of key officials that will play a part in the establishment and implementation of the Kenyan EPZ regime. In order for the program to benefit from the broad-based support that will be crucial for its success, the EPZ Committee should be reorganized to include strong private sector representation. (Ideally, its composition should approximate that of the Board of Directors of the EPZ Authority, as outlined in Chapter 6.) The meetings of this EPZ Working Group can then serve as an open forum for discussions regarding the drafting on the EPZ legislation, and its implementation, once enacted.

8.03 The Implementation Plan (Figure 8-1) presented on the following pages is, essentially, an Action Plan to guide the activities of the EPZ Working Group. As it indicates, seven primary Objectives have been identified, ranging from drafting and enactment of the EPZ legislation, to establishment of the EPZ implementation and administrative framework, to the initiation of zone promotion and auxiliary efforts in support of the integration of the EPZ program in the domestic economy. To a certain extent, these objectives can be pursued concurrently -- the GOK can move ahead on multiple fronts in its formulation of the program, as reflected by the completion dates targeted for the Implementation Measures identified in the diagram. The overall timeframe proposed for the Implementation Plan is one year, although much will depend on both the success of the Working Group in developing a consensus on the Key Issues identified, and the practicalities of the execution of the associated tasks. Each of the objectives presented in the Plan is discussed separately below.

Previous Page Blank

FIGURE 8-1

KENYAN EPZ PROGRAM IMPLEMENTATION PLAN

OBJECTIVES	KEY ISSUES	IMPLEMENTATION MEASURES		
		By May 1990	*By September 1990*	*By January 1991*
1. Enact internationally competitive legislation and implementing regulations.	- eligibility criteria for users and developers - automaticity of benefits - incentives offered - one-stop-shop	-meet with key GOK institutions involved in policy definition - address structural and operational constraints identified in existing MUB and EC schemes - draft and enact EPZ enabling legislation	- define key operational elements, procedures, sanctions to apply to firms with EPZ status within the framework set forth in the law - working with legal counsel, draft implementing regulations stipulating operating rules and procedures for EPZs	- publish guidelines on EPZ program in brochure format; outlining procedure step by step; description of incentives
2. Establish lead institution for EPZ program administration.	- definition of goals and objectives - legal structure; composition of board (private, public, mixed) - sources of funding - scope of authority - mechanisms to ensure effective implementation (one-stop-shop)	- undertake exposure tour to leading EPZ programs - submit detailed recommendations to the GOK with regard to the optimal structure of the EPZA	- incorporate EPZA - appoint board - hire manager - begin staff training - develop internal procedures	- sponsor seminar on EPZ program for local business community; introduce EPZA and explain its role
3. Establish requisite GOK institutional framework and implementation mechanisms.	- formation of special Customs unit for expedited EPZ clearance procedures - establishment of unrestricted foreign exchange access for EPZ firms - port/airport clearance procedures	- conduct internal assessments of Customs and Central Bank to identify optimal mechanisms to expedite treatment of EPZ users; determine feasibility of computerizing Customs documentation.	- develop procedures manual for key implementing agencies, including: Customs, Central Bank, KPA, etc.	- hold workshop on the EPZ program for GOK practicioners, including Central Bank, commercial banks, Customs, KPA.
4. Designate initial EPZ developers/EPZ locations.	- both industrial estates & site-specific EPZs - public, private, mixed development, ownership and management - "growth poles;" urban-based EPZs; demands on infrastructure and social services	- GOK to undertake EPZ locational analysis/ site selection study; prefeasibility assessment; examine ownership/management options	- assess alternative locations for EPZs in light of land use planning	- provide guidelines to potential EPZ developers with regard to key elements in EPZ planningand development

FIGURE 8-1

KENYAN EPZ PROGRAM IMPLEMENTATION PLAN (Continued)

OBJECTIVES	KEY ISSUES	IMPLEMENTATION MEASURES		
		By May 1990	*By September 1990*	*By January 1991*
5. Support EPZ development financing initiatives.	- government role in facilitating private EPZ financing; provision of land; infrastructure; facilities - role of international donor community - role of commercial banks - need for export financing for local manufacturers	- prepare terms of reference and secure technical assistance in design of financing mechanisms for EPZ infrastructure development - investigate alternatives for establishing credit lines for export finance	- implement recommendations for EPZ infrastructure financing strategies - introduce rediscount financing facility for EPZ development - define terms and conditions for export finance to be offered under credit line	- prepare guidelines for commercial banks for participation in the EPZ rediscount line - publish information on export credit line and activate mechanism
6. Activate EPZ marketing and promotional program.	- foreign vs. local business focus - sectoral/geographic targetting - coordination of GOK and private promotional efforts - appropriate mix of promotional techniques	- issue press releases, launch public relations campaign focussing on pending enactment of EPZ legislation - provide accurate information on EPZ legislation to Kenyan embassies overseas - revise basic promotional literature of the IPC to include information on the EPZ program	- finalize and distribute EPZ promotional literature - identify local firms with capabilities to undertake export-quality subcontracting	- undertake comprehensive EPZ dema survey in North America, EC, and A - establish linkages between promotior organizations and EPZA to ensure information exchange - develop local subcontracting/joint venture data base
7. Develop policy initiatives to integrate EPZs with local economy.	- local sales by EPZ users - export incentives for local firms supplying to EPZs - business incubator/training links	- conduct surveys to profile local export sector - identify key constraints on volume and quality of production	- distribute information on EPZ program to local business community - meet with training/vocational schools to address obstacles identified in terms of skills and training of the labor force	- meet with potential investors to identi their production needs; identify opportunities for local firms

B. IMPLEMENTATION OBJECTIVES

1. Enact EPZ Legislation and Implementing Regulations

8.04 The initial task that will face the EPZ Working Group will be to reach an agreement on the content and structure of the EPZ legislation. The GOK has already indicated its support for the enactment of a comprehensive, competitive incentive package as a basis for the Kenyan EPZ program. An related area which must be addressed is the eligibility requirements for designation as an EPZ enterprise, encompassing both users and developers of EPZ facilities. Formal agreement should be reached as to the scope and content of these incentives, and the results codified in the draft legislation.[1]

8.05 Once the incentives have been agreed upon, the task then becomes to define the structure and mechanism for their implementation. In many countries, this has proven to be more difficult and controversial than the content of the incentives themselves. Among the key questions that must be faced include how can the GOK ensure that there is "automaticity" in the EPZ regime? How can the institutional framework best be structured to function as a one-stop-shop? These administrative considerations are generally outlined in the EPZ legislation and then detailed in the implementing regulations. The law sets forth the principles of the EPZ regime and establishes or identifies the institutions that will execute the program. The implementing regulations then "operationalizes" these policy stances. A two-stage approach allows for the gradual fine-tuning of the mechanics of the program.

8.06 As outlined in the implementation plan, and based upon discussions with the GOK, the immediate goal will be to draft legislation that can be presented before Parliament in June 1990. The implementing regulations can be developed thereafter and formal guidelines published regarding the program by January 1991.

2. Establish EPZ Regulatory Authority

8.07 The structure and responsibility of the Kenyan EPZ Authority will be set forth in the EPZ legislation and the near-term actions associated with its formulation are therefore the same as those entailed in the drafting of the law. However, it is also recommended that the EPZ Working Group consider undertaking an "exposure tour" to operational EPZ programs to gather first-hand information on how other EPZ programs are regulated and administered. Countries such as Mauritius, the Dominican Republic, Ireland, or Taiwan, each provide illustrative examples of alternative approaches to program administration. During this tour, the relative merits of the various regulatory models could be discussed with both the program administrators and the users and developers of the EPZs. The trip would also provide valuable input regarding other aspects of the regime such as

---

[1] Annex E presents a model framework for Kenyan EPZ legislation, along with examples of the EPZ laws of other countries as a basis for comparison.

competitive incentive packages, ways to optimize the relationship of the EPZs to the local economy, the role of the private sector in EPZ development, etc.

8.08 Based upon the data collected and discussions held by the EPZ Working Group, the EPZA structure can be configured for inclusion in the EPZ Law. Once the law is passed, the legal basis for establishment of the EPZA will be in place, and steps can then be taken toward its incorporation, election of board of Directors, hiring of staff, and assumption of its official functions. The procedural elements of its operation will be established in the Implementing Regulations, and the EPZ Working Group should therefore "fast-track" the enactment of the regulations once the law is passed.

8.09 With the establishment of the EPZA and the passage of the Implementing Regulations, the basic institutional framework will be in place that is needed to administer the regime. It is recommended that the EPZA sponsor a seminar for the local business community at this time, introducing the EPZ program, the services that the EPZA will perform, and opportunities that are now open to local firms wishing to take advantage of the EPZ regime.

3. Establish the GOK Institutional Framework

8.10 While the EPZA will bear primary responsibility for the administration of the EPZ program, as emphasized repeatedly throughout this document, the full cooperation of the GOK is necessary if the efficient implementation of the regime is to be achieved. There are two primary areas where GOK practitioners will play a role in implementing the policies embodied in the EPZ regime -- foreign exchange access and import/export clearance procedures.

8.11 As outlined in the proposed incentives package, it is recommended that the GOK offer EPZ firms unrestricted access to foreign exchange, a benefit which should be codified in the EPZ law. The mechanism by which such access is provided must be determined by the Ministry of Finance and the Central Bank, and outlined in the Implementing Regulations. In order to devise the most efficient operating procedures, it is recommended that the GOK conduct an internal assessment of the Central Bank, to obtain primary data as to the effectiveness and shortcomings of the present Green Channel system for exporters, which will be integral to the design of EPZ automatic access procedures. Discussions should also be held with commercial banks and local exporters to develop an understanding of their respective perspectives on the effectiveness of existing procedures and what can be done to improve upon them.

8.12 Concurrently, the status of technical and financial assistance efforts that are already underway to enhance the capabilities and effectiveness of the Customs department should be assessed to identify those areas where additional resources (or a change in emphasis) may be in order. For example, there is presently a program to upgrade the information management systems of Customs through increased computerization. The data management needs that will arise from the activation of an EPZ regime should be identified and coordinated with the implementation of this program. Likewise, the shortcomings in MUB Customs practices that have been identified in this study should be evaluated in light of the importance of streamlined operations to the performance of the EPZ regime

to determine what areas are in greatest need of improvement and the optimal means to achieve "automatic" clearance of EPZ merchandise. For example, the establishment of a special EPZ Customs corps, improved systems of rewards and sanctions, simplification of documentation requirements, and other measures aimed at improved efficiency should each be evaluated in terms of their potential impact and ease of implementation.

8.13 Following the passage of the implementing regulations, detailed operational guidelines should be prepared by the GOK/EPZA for distribution to Central Bank, Customs, and also Kenya Ports Authority representatives. Ideally, a workshop can then be held introducing these newly developed practices to the individuals that will be charged with their execution.

4. Designation of EPZ Projects

8.14 If the timeline suggested in the Implementation Plan is adhered to, the requisite legislative, institutional and procedural framework for the EPZ regime should be in place by early 1991. In the interim, several steps can be taken by the GOK to provide for the rapid activation of EPZ development upon its completion. Issues requiring the immediate attention of the GOK, that should be assessed by the EPZ Working Group include the authorization of single-user EPZ facilities, and the legal provision for alternative forms of EPZ ownership and management. The Government has indicated its support for the private sector to take a leading role in EPZ development in Kenya. To the extent that the GOK has benefit of donor-financed technical assistance in support of EPZ development, the optimal targeting of these resources should be determined.

8.15 One area where the GOK can be of particular assistance in EPZ development is in the provision of the requisite external infrastructure and services "up to the gate." In addition, given the relatively high cost of land and land development in Kenya, the GOK may wish to consider providing land to private management companies under a long-term lease arrangement for EPZ development, or alternatively, assuming the cost of land preparation for privately developed projects. Options such as these (as well as the financing alternatives discussed below) should be considered by the GOK, and discussions held with private foreign and local development groups to assess their level of interest in each. In other EPZ host countries, USAID and the World Bank have provided technical and financial assistance in pre-investment analysis, development financing, and installation of on-site and external infrastructure. Preliminary analysis with regard to the physical development of EPZ facilities can, to a certain extent, be parallel-tracked with the establishment of the institutional and regulatory framework described above.

5. Financial Support for EPZ Development

8.16 Financial support for the development of EPZs will be needed in two distinct areas: financing for EPZ physical development, both infrastructure and facilities, and (ii) access to export financing for local EPZ users. With regard to the physical development of the EPZ site, financing is typically required for: site acquisition and preparation; internal infrastructure and facilities

development; and external infrastructure development. Installation of the requisite external infrastructure is unlikely to present a major problem in Kenya; the GOK has generally proven able to meet the utilities and service needs of industrial developers, and it is also likely that donor assistance could be secured, if necessary, from the World Bank or USAID, once a EPZ project had been identified.

8.17 However, the analysis of the Kenyan financial sector undertaken as a part of this study indicates that, at present, local sources of long-term financing at suitable terms and conditions for on-site development of a private EPZ are simply not available. Given that the GOK wishes to stimulate private sector ownership and management of EPZ projects, the GOK should consider the design of a new financing mechanism to meet the accompanying need for development finance.

8.18 It is recommended that over the next year, the GOK work with the donor community to examine alternative approaches to the provision of development financing, such as establishment of a rediscount facility for EPZ development. USAID has recently established such a mechanism in El Salvador as a source of development finance for private EPZs, and the World Bank and U.S. Overseas Private Investment Corporation have also served as sources of long-term lending for EPZ development in other countries.

8.19 In addition to financing of EPZ infrastructure, the GOK may wish to consider the provision of preferential access to financing for local exporters to meet their working capital requirements. Difficulties in obtaining requisite financing for financing of imports, the reluctance of banks to issue back-to-back letters of credit were repeatedly mentioned by local manufacturers as obstacles to their operation. The development of a comprehensive export credit guarantee scheme should be extended by the GOK as an adjunct to the EPZ program.

8.20 Over the next 12 months, the GOK should investigate the alternative sources of financing available to it in support of these initiatives, and arrive at a determination as to feasibility of establishing these new credit mechanisms. Optimally, programs would be put in place as soon as the legislative framework was established so as to lay the groundwork for immediate access once the EPZ regime becomes operational.

6. Activation of EPZ Marketing and Promotional Program

8.21 The marketing and promotion of an EPZ regime is arguably second only to the establishment of a competitively configured legal and regulatory framework in its bearing on the success of the program. As discussed in the market and demand analysis, the competitive environment which characterizes EPZ development worldwide requires a concerted effort on the part of both the national promotional bodies and the individual EPZ projects to identify and publicize the comparative merits of the program.

8.22 In this light, several steps can be taken in the near term toward the initiation of an EPZ promotional effort in Kenya. It is recommended that the EPZ Working Group provide periodic updates on the status of the EPZ legislation, both the law and the implementing regulations, to the press and promotional

agencies, as they are drafted and enacted. For the local audience, additional data can be furnished regarding the impact and performance of EPZ programs elsewhere in the region and the world, and the potential the regime offers for participation of local businesses as both EPZ developers and users.

8.23 Once the legislation is passed, the IPC should incorporate information on the regime in its standard promotional literature, and prepare a stand-alone brochure on the incentives available under the program to foreign and local businesses. This promotional material should be distributed to foreign embassies and relevant GOK offices to be provided to potential investors in the program. In a related area, the GOK may wish to consider charging the Department of External Trade with responsibility for identifying local firms interested in exploring joint venture or sub-contracting opportunities within the EPZ program. Comprehensive data bases can thereby be developed and forwarded to potential foreign investors.

8.24 Special attention should be directed toward establishing solid communications between the EPZA and the lead EPZ promotional organization, be it the IPC or an independent entity. The EPZA should keep promotional units abreast of new developments in the implementation of the program. Once the legal groundwork for EPZ development has been established, a full-scale market survey should be undertaken to assist the IPC or other promotional group in its marketing and promotion efforts. The results of such a survey can then be used to determine the high-potential geographic and sectoral areas for future promotional initiatives.

7. Integration of the EPZs with the Local Economy

8.25 One final area that will require GOK attention is the development of linkages between the EPZ program and the local economy. Despite the success of EPZs in generating employment and increasing foreign exchange earnings in their host countries, in many programs the integration of EPZ activity with that of the domestic economy has been limited. To foster the establishment of an EPZ program that will provide opportunities for increased economic growth locally, it is recommended that an inventory of the local manufacturing sector be conducted to identify key constraints on the volume and quality of its production. As discussed throughout the report, one of the primary obstacles to backward linkages from EPZs is the absence of locally sourced goods at competitive prices and at world quality standards. If shortcomings in production methods and quality control measures are identified early on, steps can be taken to address them prior to the initiation of EPZ activity. Optimally, such firms may even be potential candidates as users of Kenyan EPZ facilities, if efforts are made to increase the competitiveness of their output.

8.26 In addition to re-orienting the Export Compensation scheme to reward "exports" of local products to the EPZ sector, the GOK should consider devising multiple schemes that re-orient the production of local manufacturers to the export market. Among the various alternatives include a modern, duty-drawback mechanism, and income tax exemptions linked to export value-added.

8.27 From a different perspective, the analysis conducted as a part of this report identified shortcomings in the skill base of the Kenyan labor force, particularly with regard to managerial and technical personnel. While such shortcomings are prevalent throughout the developing world and are generally assumed to be encountered by firms considering alternative offshore locations, to the extent that programs can be initiated to redress technical and managerial inadequacies in the labor force, the opportunities for higher value-added activities by local workers will be increased, and the concomitant economic benefits of the EPZ program multiplied. Notable successes have been achieved in those EPZ sponsoring countries that have supported the integration of vocational and technical training efforts with their EPZ development initiatives.

8.28 Finally, as the EPZ program is established, potential investors should be provided accurate information in these areas -- locally available goods and services, training programs in place for their workforce, etc. -- so that the local availability of production inputs and skills can be taken into consideration in their decisionmaking. The efforts of the various technical and promotional units within Kenya should therefore be coordinated and communication maintained on a regular basis.

ANNEX A

INTERVIEWS CONDUCTED

ANNEX A

INTERVIEWS CONDUCTED

A. GOVERNMENT OF KENYA AND PUBLIC SECTOR OFFICIALS

Ministry of Industry

Hon. Dalmas Otieno, Minister
Dr. W.K. Koinange, Permanent Secretary
Mr. A. Vienna, Deputy Secretary

Office of the Vice President and Ministry of Finance

Prof. T.C.I. Ryan, Economic Secretary
Mr. R.K. Bhatia, Advisor

Customs & Excise Department, Ministry of Finance

Mr. F.C. Cheruyoit, Commissioner
Mr. Al Amin, Senior Assistant Commissioner
Mr. N.O. Odindo, Senior Assistant Commissioner
Mr. T.K. Mbugua, Senior Collector

Ministry of Commerce

Mr. R.C. Makokha, Director of External Trade
Mr. M. Ngali, Undersecretary

Office of the President

Mr. Fred Kwinga, Principal Immigration Officer

Ministry of Labour

Mr. J.M. Mutugi, Commissioner of Labour

Investment Promotion Centre

Mr. Silas Ita, Managing Director
Mr. George Ng'ang'a, Investment Promotion Manager

Kenya Ports Authority

Mr. John Mwawasi, Planning Officer

Kenya Industrial Estates

Mr. A.M. Shikule, Assistant Managing Director

Ministry of Planning and National Development

Dr. I. Njeru, Deputy Chief Economist

Capital Markets Advisory Council

Mr. W.K.B. Arap Chelashaw, Secretary/Chief Executive

Central Bank of Kenya

Mr. Elly Otondi, Head, Investments Division
Mr. B.K. Ihuthia, Imports Division

B. UNITED STATES GOVERNMENT

U.S. Agency for International Development

Mr. Eric Zallman, Deputy Mission Director
Mrs. Holly Wise, Chief, Private Sector Office
Mr. Migwe Kimemia, Private Sector Advisor

U.S. Embassy

Mr. Paul Behnke, Economic Counsellor

C. KENYAN PRIVATE SECTOR REPRESENTATIVES

Bamburi Portland Cement

Mr. D.C.J. Muli, Marketing Manager

Barclays Bank of Kenya

Mr. D.V. Chauhan, Manager, Foreign Exchange Centre

Bata Shoe Company

Mr. Hugo Mendoza, Managing Director

Bonar (EA) Ltd.

Mr. Mike Sheppard, Managing Director

Brother Shirt Factory Ltd.

Mr. Shashi Kant, Director
Mr. Pravin Chandra, Director

Car & General (K) Ltd.

Mr. N.B. Jones, Managing Director

Combined Warehouses Ltd.

Mr. F. Jamal, General Manager

Comcraft Industries

Mr. Manu Chandaria, Chairman

Comprite Services

Mr. Salim Talib, Managing Director

Conveyors Limited

Mr. Charles Githinji, Imports Manager

Dayrite Mills

Mr. S. Mbogo Kamau, Chairman

East Africa Industries

Mr. C.V. Sodha, Export Unit Manager

201

Equator Bank

Mr. S. Cashin, Merchant Banking

Express K Limited

Mr. E. Habermacher, General Manager
Mrs. N.N. Ndichu, Transport Manager

Fine Garments Ltd.

Mr. Leonard Kibinge, Director
Mr. Lee Ngugi, Chairman
Mr. Fred Njoroge, Managing Director

Hailat Knitting Enterprises

Mr. H. Girmey, Managing Director

Hercules Mills Ltd.

Mr. Bipin Vora, Managing Director

ICL Kenya Ltd.

Mr. John M. Okech, Managing Director

Joy Shoes Ltd.

Mr. M. Michuki, General Manager

Kamiti Tanners Kenya Ltd.

Mr. W. Magugu, General Manager

Kenya Association of Manufacturers

Mr. J.W. Kuria, Chief Executive
Mr. Kiarie Kamanu, Executive Officer

Kenya Canners/Del Monte

Mr. J.P. Mbogua, Director

Kenya Equity Management

Mr. Bruce Bouchard, Managing Director

Leather Industries of Kenya Ltd.

Mr. J. Nderitu, Projects Manager

Midco Knitwear Ltd.

Mr. J.V. Shah, Managing Director

Mitchell Cotts

Mr. Jonathan Mburi, General Manager

Multiform Interlining Manufacturing (Lanka) Ltd.

Mr. Lakshman Perera, Managing Director

NACOL Nairobi

Mr. Paul K. Waruhiu, Managing Director
Mr. J.E. Maina, General Manager

The National Pencil Company

Mr. Pius Ngugi, Chairman

Ndung'u Njoroge & Kwach Advocates

Mr. Eliud N. Njoroge, Partner

Pan African

Mr. A. Khan, Banking

Pan African Paper (EA) Mills

Mr. H.K. Bansal, Dy. Commercial Director

D. FOREIGN PRIVATE SECTOR REPRESENTATIVES

Almina Surfati

Mr. Matrenges, Director of Logistics

Aquitaine de Pret-a-Porter

President Director-Generale

Batts' Inc.

Don Morgan, Vice President -- International

Brown Shoe Company

Gerald Collier, Director of International Operations

Chicoppe, Inc.

Deborah S. Anderson, Marketing Specialist

Coats Vivella PLC

Max Pirks, Overseas Logistics Manager

Connors Footwear

Gregory Connors, President

Corah PLC

Mr. Fletcher

Courtaulds PLC

A.G. McClean, former Chief Executive Officer -- Overseas Operations

Daewoo Electronics Co., Ltd.

John Park, Director of General Affairs

210

Pan Plastics Ltd.

Mr. Amritlah Shah, Managing Director

Phillips Kenya

Mr. T.C. Cohen, Chairman/Managing Director

Premier Food Industries Ltd.

Mr. J. Nderitu, Projects Manager

Salim Dhanji Advocates

Mr. Salim Dhanji, Advocate

Shah Patel & Co.

Mr. Shanti K. Shah, Accountant

Trufoods Limited

Mr. J.V. Vanjara, Finance Director

Tysons, Ltd.

Mr. Joseph Gitonga

DeWitt Footwear

Marvin Haber, Vice-President, Manufacturing

Doosan Ind. Co., Ltd.

Kim Kyong, International Sales Manager

French Connection PLC

Stewart Selwyn, Director of Planning

Fink Unternehmensgruppe

Director of Operations

Hyosung Corporation

Glen Heller, Controller

Motorola Korea Ltd.

Vincent Sheehan, Operations Manager/New Investment

Pellon, Inc.

Edward McCann, Vice President -- Manufacturing

Rau Fasteners, Inc.

Francis Basile, Vice President -- Finance

Revelations Shoe Corporation

Hans Hansen, Executive Vice President

Samsung Electronics Co., Ltd.

I.H. Kim, General Manager

Sierra Western Mfg.

Carlos Ramirez, Controller

Steilman Gruppe

Mr. Steilman, President

Trumpf Gruppe

Mr. Voigtlander, General Manager

Wolowick Shoe Mfg. Company

James Wolowick, President

ANNEX B

PROPOSED KENYAN EPZ PROMOTIONAL STRATEGY

ANNEX B

PROPOSED KENYAN EPZ PROMOTIONAL STRATEGY

A. INTRODUCTION

An extremely important, but often overlooked, key to successful EPZ development is the design and implementation of an effective strategy for EPZ marketing and promotion. Given the highly competitive nature of international market demand for offshore manufacturing facilities, it is essential that Kenya develop both the resources and institutional capacity to undertake effective promotion of any prospective EPZ. In addition, it is important that the design of this marketing strategy commence in the earliest planning stages of the Kenyan EPZ program. This is necessary to ensure that promotional efforts do not lag behind institutional and regulatory developments; moreover, effective marketing and promotion is absolutely critical to the success of a private EPZ because of the need to generate revenues as quickly as possible.

In most nations with successful EPZ programs, zone promotion is closely linked to the country's overall investment promotion efforts. A well-designed and well-managed program will not only attract both foreign and local investment, but over time can also encourage investment in non-EPZ locations throughout the country.

This annex addresses both institutional and programmatic aspects of a proposed EPZ promotional strategy for Kenya.

B. THE EPZ PROMOTION PROCESS

1. EPZ, Investment, Export, and EPZ Promotion

EPZ promotion in any country is generally linked closely to overall national investment and export promotion efforts. Nonetheless, it is useful to think of investment, export, and EPZ promotion in distinct terms, as each addresses a somewhat different aspect of the "promotion equation".

From a marketing perspective, investment promotion focuses primarily on "selling" a host country as a site for business activity. In the broadest sense, promotion efforts can be directed both at locally and foreign investment; at export-oriented investment as well as investment oriented toward selling in the local market; and at investment in virtually any economic sector in which private capital is welcomed by the host government. In contrast, export promotion generally focuses on encouraging the overseas sale of specific products. Such products are usually already produced in the host country -- for example, traditional agricultural exports -- but export promotion also includes the encouragement of nontraditional exports such as manufactured goods.

EPZ promotion incorporates elements of both investment and export promotion, but differs in that the principal product being marketed is not a specific good or country. Instead, EPZ promotion advertises a package of national policies and production factors which meet the needs of export-oriented industries.

In many countries with successful EPZ programs, the national promotion agency is given primary responsibility for EPZ promotion as part of its overall investment promotion efforts. In other countries, particularly those with multiple, industrial park-type EPZs, the national promotion agency limits its role to promotion of the country as a site for investment in offshore production, leaving to individual EPZ operators the responsibility for marketing their respective zones.

2. Elements of Successful EPZ Promotion

Strategies and approaches to investment and EPZ promotion have been quite varied, as has been the degree of success enjoyed by countries which have engaged in promotional efforts. Many countries have viewed investment promotion principally as a public relations exercise, and have engaged in multimillion dollar promotional campaigns, often with mixed results. Other countries have focused their efforts on the packaging and marketing of individual investment projects, without developing the requisite institutional capacity to meet investors' informational needs and business advisory support requirements.

The countries which have been the most successful in promoting EPZ investment are those which not only understand the factors which influence investors' decisionmaking, but which tailor their promotion programs and institutions to respond directly to the interests and requirements of prospective investors. Thus, the design of an EPZ promotion strategy must take into account the various forms of government-business interaction as they relate to investor decisions. There are five key functions that must be carried out in the process of EPZ promotion:

1. **Adoption of appropriate economic policies and legal provisions.** While many of the factors shaping a country's investment climate -- such as geographic location, natural resource endowments, and population size -- are outside of government control, governments do have full control over the policy, legal, and regulatory environment facing investors. These responsibilities generally lie outside of the authority of the investment promotion agency, or EPZ operator per se, but all parties should recognize that the most effective action that any government can take to attract investment is to provide a supportive policy environment for export production. Indeed, without such an environment, firms will not even be attracted to an EPZ. This is also important in light of the fact that in many EPZ-sponsoring countries local firms are the initial entrants to the program. Countries such as Taiwan and South Korea commenced their rapid economic growth by introducing policies that made export production by local companies more attractive than other investment opportunities.

2. **Development of information on investment conditions and opportunities.** A promotion agency must be able to provide businessmen with accurate and up-to-date information on investment conditions, opportunities, and requirements. Thus, the development of promotional materials is one of the first steps to be undertaken by any promotion agency. Promotional material can range from simple, mimeographed brochures to more

2/16

sophisticated films and videos. No matter what medium is chosen, it is important that promotional materials convey accurate information in an honest fashion. Serious investors are sufficiently sophisticated to see through glib or misleading statements. Furthermore, businessmen are primarily interested in obtaining information pertinent to their investment decisionmaking, rather than generalized information which is overly descriptive and lacking in specificity, particularly with regard to costs.

3. **Marketing efforts.** Marketing efforts are crucial to connecting potential investors with the EPZ program. Such initiatives must aim first at attracting investor interest in the country as a whole, and second in a specific EPZ. As will be discussed in further detail below, marketing activities involve a wide range of techniques, including advertising, public relations, direct mail campaigns, and investment seminars and missions.

4. **Investor assistance and advisory services.** Once investors have expressed interest in a country or in a specific EPZ, there must be one centralized agency which is capable of providing additional information and assistance on aspects of the promotion process. In the case of foreign investors, some of this assistance must initially be made available overseas. Such information may be provided directly, through a national promotion agency, or thorough the host country's embassies, consulates, or overseas trade promotion centers. Alternatively, this function can be carried out through national banks, law firms, or consulting organizations hired for this purpose.

5. **Investment screening and approval.** Whether undertaken by the investment promotion agency, or by some other government body, the final step in the promotion process is the screening and approval of investment applications and the granting of permits and incentives (if applicable) required by the investor to begin operations. This is often the most critical part of the investment process. In the most successful EPZs, the investment approval process has been streamlined into one simplified application process. Moreover, the existence of such a "one-stop-shop" is in itself an important promotional tool.

3. Institutional Approaches

The precise promotional and administrative structure governing EPZ investment differs widely between countries. Variations of institutional structures reflect differences in governmental systems, investment priorities, institutional arrangements, resource availability, size and structure of the EPZ program, and the degree of private sector involvement. Nonetheless, while there is no single ideal institutional model, there are a number of organizational characteristics which have been found to be most effective.

First, the agencies charged with carrying out the five key functions discussed above should be integrated as closely as possible. Successful EPZ promotion -- as well as administration, because the efficiency with which the EPZ program

is administered will also promote the program -- requires a strong degree of coordination and cooperation.

Second, the organizational structure of the promotion process should be as simplified as possible. Business executives place a high premium on clarity and transparency in their dealings with government. If the process of obtaining information, applying for investment approvals, and receiving EPZ designation is complicated and overly bureaucratic, investors will perceive this complexity as reflective of business conditions as a whole within the country. More importantly, potential investors will look elsewhere to other EPZ programs which are not characterized by such bureaucratic complexity and delays.

Finally, EPZ promotion structures should ideally include strong private sector representation. Not only are private businessmen most aware of the interests and requirements of investors, but their participation in the promotion process will help to demonstrate to potential investors that the government is capable of working with private business.

A common difficulty faced by promotion agencies worldwide -- whether public, private, or mixed-ownership -- is funding. Without proper human and material resources, effective promotion is virtually impossible. Approaches to the problem of financing investment and EPZ promotion have varied. In many countries, promotion agencies are funded entirely by host governments. Others receive a large percentage of their funding from international donors.

Recently, both donor institutions as well as cash-strapped governments are encouraging financial self-sufficiency on the part of promotion agencies. Approaches that have been tried or suggested for achieving self-financing have included taxes or other assessments levied on new investments and earmarked to fund promotion; commission payments from EPZ operators to promotion agencies for every new investment; user charges to prospective investors and service providers; and the sale of advertising space in promotional literature.

In reality, the goal of self-financing has proved to be illusory. In virtually every country which has been successful in promoting investment and EPZ development, the host government and/or local private sector have recognized that investment promotion is a "public good," worthy of financial support. Rather than achieving financial self-sufficiency, attempts by promotion agencies to generate their own resources have tended to divert efforts away from effective promotion, and/or to compromise their objectivity and credibility with investors. Nonetheless, this does not mean that financial levies or assessments of some sort cannot be used to help to offset the financial burden of promotional efforts, but rather, that they will not supplant the need for other sources of funding.

4. Promotion Experiences of Selected EPZ Locations

a. Dominican Republic

EPZ promotion in the Dominican Republic is undertaken jointly by the country's national investment promotion agency -- the Investment Promotion Council of the Dominican Republic (IPC/DR) -- and individual EPZ operators. Regulation of EPZ's

is the responsibility of a separate institution -- the National Free Zone Council -- which plays no promotional role.

The IPC/DR is a private, non-profit corporation governed by a board of directors which includes both public and private sector representation. Its annual operating budget is less than US$1 million, and is funded by a grant from USAID, the Dominican Government, and by dues paid by its members. The total IPC/DR staff, including support personnel, is just over 30 persons.

While the IPC/DR's mandate includes promotion of investment in all economic sectors in which the Dominican Republic offers competitive advantages, its major emphasis has been on promoting investment in the country's EPZs. Accordingly, the organization has developed specific promotional materials describing and comparing the alternative EPZ locations available in the country. A comprehensive brochure provides information regarding the location, size, sectoral orientation, available labor supply, distance from ports and airports, and factory lease price for each EPZ. A highly useful, single-paged chart which summarizes the price and locational attributes of the country's EPZs is also included. In order to control costs, all promotional materials are prepared in-house, using desk-top publishing methods. In addition, the IPC/DR has developed a promotional video which highlights the country's EPZ program. This video is available to individual EPZs for use in their own promotional efforts.

While EPZ promotion is an important element of the IPC/DR's overall investment promotion program, it is careful not to appear to favor or discriminate against any single EPZ or group of EPZs. Accordingly, investors are provided with general information regarding all EPZs in the country, and site visit schedules arranged by the IPC/DR generally include visits to a number of free zones. While IPC/DR investment counselors accompany investors on these visits, it is up to individual EPZ operators to "sell" the advantages of their respective zones. The marketing approaches employed in this respect vary from zone to zone. Nearly all of the zones have developed printed promotional and informational materials. Some have also developed promotional videos and slide presentations. While most of the zones rely on the IPC/DR to undertake overseas marketing of the Dominican Republic as a site for offshore manufacturing, some private EPZs also undertake their own overseas marketing programs.

The IPC/DR focuses primarily on selected target industries which seem most appropriate for location in an EPZ; the organization does not ignore investment leads coming from other industry sectors, but concentrates the majority of its time and funds on sectoral promotion. Given the size of the Dominican Republic's EPZ program, and the intense competition among individual EPZ operators to attract tenants, a certain degree of overlap between the IPC's promotional efforts and those of individual EPZ operators is inevitable. For the most part, however, the division of responsibility between the two groups has been respected, and individual EPZ operators have recognized the importance of providing the IPC/DR with up-to-date information regarding their zones.

b. Mauritius

EPZ promotion in Mauritius is undertaken principally by the Mauritius Export Development and Investment Authority (MEDIA). Like the IPC/DR, MEDIA has a mixed public and private sector board of directors, but the agency is a parastatal organization, attached to the Ministry of Industry. While MEDIA does not have specialized promotional literature aimed at EPZ promotion, all of its general promotional literature advertises the EPZ "package" as one of the country's major selling points as a site for offshore investment.

In addition to its role as Mauritius' lead investment promotion agency, MEDIA also develops and leases or sells factory space to firms interested in establishing offshore manufacturing operations under the EPZ program. To date, MEDIA has constructed over 27,870 sq.m. (300,000 sq.ft.) of factory space at various locations around the country. Instead of building industrial estates, MEDIA usually constructs one or two buildings at any given location. MEDIA is not the only source of industrial buildings, but competes with private developers and industrial estates constructed by the fully government-owned Development Bank.

MEDIA's dual role of EPZ developer and EPZ promoter creates potential conflicts of interest. This potential conflict has been cited by some analysts as a reason behind the reluctance of private sector groups in Mauritius to invest in the development of EPZ infrastructure.

c. Taiwan

Taiwan was one of the first countries to utilize EPZs as a means of promoting investment in export-oriented manufacturing. Taiwan established its first EPZ at Kaohsiung in 1966. This was followed by additional zones at Taichung and Nantze in 1971, and in 1980, by the establishment of the Hsinchu Science-based Industrial Park which is aimed at attracting investment in high-technology industries.

For over two decades, the Industrial Development and Investment Center (IDIC) has served as Taiwan's lead investment promotion agency. As part of its overall promotional program, IDIC stresses to investors the advantages offered by locating in an EPZ. Nonetheless, as the distinctions between the incentives offered to EPZ investments and those geared to production both for export and for the local market have become blurred, the need for the IDIC to highlight EPZs in its investment promotion efforts has been diminished.

Responsibility for EPZ promotion is shared by the IDIC and the Export Processing Zone Administration, a public sector organization which operates the country's EPZs. IDIC, along with the China External Trade Development Council (Taiwan's national export promotion agency) provide brochures and information about the country's EPZs as part of their standard information package. The brochures instruct investors to contact the Export Processing Zone Administration for specific information regarding the country's EPZs. The EPZ Administration also has produced a specialized brochure on EPZs, which is distributed through the IDIC and CETDC.

To ensure coordination of Taiwan's promotion efforts, the IDIC, CETDC, and the EPZ Administration, along with the agency responsible for granting investment approvals, are all placed under the authority of the Ministry of Economic Affairs.

d. Lessons for Kenya

These brief examples of EPZ promotion provide an overview of the way EPZ and investment promotion efforts are coordinated in three successful EPZ countries. In both Mauritius and the Dominican Republic, promotional efforts are headed by a combination of private and public sector representatives. In Taiwan -- as in the other successful Asian exporting countries -- the promotional agency is a public sector body. Nonetheless, in each of the four Asian NICs, the private sector plays an important role in promotional efforts. Membership associations, chambers of commerce, and private service and financial firms all provide training and advice to exporters.

C. CURRENT PROMOTIONAL PROGRAMS IN KENYA

There are a number of GOK institutions that are currently involved in investment and/or export promotion. These institutions include the Investment Promotion Centre (IPC), the Department of External Trade within the Ministry of Commerce, and Kenya's overseas embassies.

1. Investment Promotion Centre

The Investment Promotion Centre is Kenya's national investment promotion agency. First established in 1982 as a department of the Ministry of Finance, the IPC is designated as the GOK's primary point of contact for potential investors.[1]

The day-to-day management of the IPC is the responsibility of the Managing Director. The Centre's professional staff includes five technical officers. Like many other African promotion organizations, the IPC has tended to take a "project-specific" approach to investment promotion. Accordingly, the IPC is divided into both a Projects Department and a Promotion Department. The bulk of the activity of the Projects Department has involved the identification of suitable projects or sub-sectors for investment. The role of the Promotion Department is to respond to investor inquiries and to organize and carry out promotional activities in Kenya and abroad. In addition, since 1988, the IPC has been responsible for the administration of the Manufacturing-Under-Bond Scheme, although MUB licenses are issued by Customs upon recommendation of the Minister for Finance.

In comparison with the national promotion agencies found in other EPZ countries, the IPC suffers from a number of deficiencies in terms of both available

---

[1] The institutional background of the IPC is discussed in Chapter 6 of the main report.

resources and current administrative procedures. In terms of resources, the IPC's effectiveness is severely constrained by inadequacies in staff, facilities, and materials. While the technical staff appear to have an adequate knowledge of current investment procedures and opportunities, many of them are unfamiliar with basic investment promotion techniques, and have little understanding of private investor requirements. The IPC's offices are in need of major refurbishing; at present they do little to convey a "businesslike" atmosphere that reassures investors that the organization is effectively run and receptive to the investor's needs.

With respect to materials, the IPC has recently published a four-volume investor guide which provides a good deal of general information on Kenya, its resources, and investment opportunities. The guidebooks are published in four-volume format, however, which is both cumbersome for investors and contains much redundant information. The IPC has also recently developed a computerized investor tracking system and data base on investment conditions. To date, however, only one member of the technical staff has been trained in the use of the system, and the data base is not yet complete.

The IPC's "project-oriented" approach also is inappropriate for effective EPZ promotion. Experience worldwide has shown that identification and "packaging" of discrete investment projects for "sale" to prospective investors is not a cost-effective investment promotion approach. A recent study of investment promotion experiences of 30 countries worldwide was not able to document a single case of successful promotion of new investment via the "project" approach.[2] By contrast, those investment and EPZ promotion which have been successful have focused on communicating a country's or individual EPZ's attributes as a site for investment, leaving up to the individual company or entrepreneur the responsibility of defining the appropriate scale, technology, and financing mix for their projects.

The majority of Kenya's investment promotion deficiencies are related more to procedures, however, than to the limited resources or promotional approach of the IPC. The principal procedural difficulty is the cumbersome investment approval process. As described in Chapter 3, the IPC has compiled a list of 34 different approvals, involving 20 different government agencies, that may be required for new investments; additional approvals may be required for foreign investors. Despite the creation in 1987 of a "one-stop approval process" through the IPC and a high-level Investment Facilitating Committee, investors still report delays of 3 to 6 months in receiving approvals. Furthermore, a number of ambiguities still remain in the requisite procedures and criteria for approval of new investments.

A key challenge before any prospective EPZ promotion program in Kenya will be the need to address these deficiencies. As noted elsewhere in this report, automaticity and transparency in investment approvals are a key element of virtually all successful EPZ programs.

---

[2] L.T. Wells and A.G. Wint. "Marketing a Country: Promotion as a Tool for Attracting Foreign Investment", November, 1988.

2. The Department of External Trade

Kenya's experience with export promotion dates to 1965 when the GOK and the Kenyan Association of Manufacturers created the Kenya Export Promotion Council. In 1976, the council was reconstituted as the Kenya External Trade Authority (KETA). The organization was given the responsibility for developing and implementing a strong export promotion program. KETA was established as an independent parastatal modeled on lines similar to those of successful Boards of Trade in other countries. With its Chairman and many members of its Board of Directors drawn from the private sector, KETA functioned for a number of years as an effective, dynamic trade promotion entity, participating in overseas trade fairs and offering seminars and conferences on export procedures at home.

A major feature of KETA was the existence of specialized committees, each composed of representatives from both the public and private sectors, which served as important fora for the discussion of the appropriate policy and procedural requirements for fostering export growth. In 1985, however, the private sector representatives withdrew their participation, citing GOK neglect of the agency. As a result, KETA has effectively ceased to exist as an institution and its functions have been assumed by the Ministry of Commerce's Department of External Trade, although the Department is still often referred to as KETA.

The official export promotion functions of the Department of External Trade fall into four categories:

(1) the expansion and diversification of Kenya's exports and export markets;
(2) the formulation of GOK trade policy;
(3) the negotiation and monitoring of bilateral trade agreements; and,
(4) the monitoring of multilateral trade agreements.

The Department is organized into two divisions, one for Trade Promotion and one for Trade Policy. Like trade promotion departments in other countries, Kenya's Trade Promotion Department is responsible for both marketing and market research. The Department also organizes training programs for Kenyan exporters.

As with the IPC and GOK investment promotion efforts in general, KETA's ability to undertake successful export promotion is severely undermined by national policy and procedural weaknesses and constraints which act to impede exports. As discussed in Chapter 3, these include a strong anti-export bias in GOK trade policy and a cumbersome GOK administrative apparatus.

3. Overseas Embassies

A final element of Kenya's existing investment/export promotion structure is the GOK's network of overseas Commercial Attachés. There are 15 such attachés posted in embassies and consulates around the world. The attachés are also part of the Ministry of External Trade. Each is responsible for a large area of territory or for more than one country. In most cases, one person is responsible for all functions relating to trade, investment, and tourism. Most attachés have little

or no practical business experience and are provided with insufficient resources, materials, or information to respond adequately to businessmen or to commercial enquiries from home or abroad.

4. Implications for EPZ Development in Kenya

The above analysis of the existing investment and export promotion framework in Kenya has demonstrated that in order for the GOK to develop a successful EPZ promotion program, a number of institutional and procedural changes must be implemented. From an institutional perspective, both the IPC and the Department of External Trade need to become more "businesslike" in both their operations and appearance. This will require additional training of the existing technical staff, and/or an infusion of staff with private sector backgrounds and experience.

Effective mechanisms will also have to be developed to include representative private sector participation in both IPC and KETA. Most analysts trace the decline of KETA as an effective promotion entity to the withdrawal of private sector representation and support. Similarly, the private sector members of IPC's Board of Directors have been frustrated by their inability to make any significant inroads in streamlining the current investment approval bureaucracy. Worldwide experience has shown that the best promoters of a country or EPZ location are investors already successfully located within the country. By integrating both local and foreign investor participation into promotion activities, the credibility and effectiveness of these activities can be enhanced considerably.

Both IPC and KETA also need to develop information bases and staff expertise in the light manufacturing sectors (apparel, electronics, footwear, etc.) that are likely to be the major areas of EPZ investment. IPC and KETA staff must be able to speak knowledgeably to investors about their requirements in order to demonstrate how a Kenyan EPZ can meet the special needs of these industries. The Dominican IPC, for example, has organized its staff along these industry-specific lines, rather than by geographical region, in order to work with potential investors more effectively. Successful EPZ development and promotion in Kenya will also require substantial changes in GOK procedures relating to investments and exports. Th e issues have been discussed, at length, elsewhere in this report. It will be sufficient to reiterate here that a key to effective promotion in Kenya, as in other EPZ locations, will be the development of streamlined mechanisms for investment approvals, foreign exchange access, and export clearances.

D. PROPOSED STRATEGY FOR EPZ PROMOTION

The remainder of this Annex presents a proposed strategy for EPZ promotion in Kenya, focusing on three basic elements: the institutional structure for EPZ promotion; industry/sector targeting; and marketing.

1. Institutional Structure for EPZ Promotion

There are a number of organizations that will have important roles to play in EPZ promotion in Kenya. The key organizations include the Investment Promotion Centre; the Department of External Trade within the Ministry of Commerce; and the individual EPZ developer(s) or operator(s), whether public or private.

The GOK can maximize the resources, both administrative and financial, devoted to promotional efforts by ensuring that effective coordination occurs between these agencies and groups. In addition, the promotional campaign will be more effective if it is linked to the promotional efforts by the Kenyan Association of Manufacturers or other groups, and utilizes the economic and business research and analysis produced by universities or other organizations. Such coordination not only maximizes the use of GOK resources, but also sends a single, coherent message to prospective investors.

a. The Investment Promotion Centre

As in other countries with successful EPZ programs, the role of the IPC, as Kenya's national investment promotion agency, will be to integrate EPZ promotion into the country's overall investment promotion program. The IPC's role will be to both promote the highly competitive Kenyan investment climate offered in the EPZ, as well as to use this specialized investment climate as a way to enhance investment promotion efforts overall. In order to achieve this objective, IPC promotional materials must be updated to highlight the advantages associated with Kenya's EPZ program. The IPC may also have to shift the geographic focus of its investment promotion activities to concentrate more on countries and regions that are likely to be the initial sources of foreign EPZ investment; that is, to focus less on Western Europe and more on such Far Eastern countries such as Taiwan, Singapore, South Korea, and Japan.

One of the critical investor concerns -- related in discussions with both European and Asian firms -- is the ability of Kenya to meet the quality production standards demanded in international markets. Much of this concern stems from a lack of investor awareness of Kenya's relatively well-developed manufacturing base. Thus, it is evident that to support EPZ investment, the IPC will have to better communicate to foreign investors Kenya's attractiveness and reliability as an offshore manufacturing site. One effective approach that has been used by other countries is the use of positive testimonials from investors that have already established successful manufacturing ventures in the country.

b. The Department of External Trade

The role of the Department of External Trade in EPZ promotion in Kenya should involve the identification and facilitation of opportunities for local firms to sell goods and services to firms operating within the EPZ. The experience of other countries with active EPZ programs has been that EPZ firms initially import all their inputs from established suppliers outside of the host country. This pattern can generally change over time, however, as EPZ companies discover local, reliable sources of inputs such as packaging material; increasingly, they can

then begin to source locally more sophisticated inputs such as buttons and zippers, furniture, and spare parts.

The speed with which such backward linkages can be developed, however, depends on the extent to which such linkages are encouraged. Kenya's history of import substitution, however, means that most firms are unaccustomed to producing products which must be competitive in terms of quality and timeliness of delivery, with imported inputs. Thus, the development of local sourcing of inputs by EPZ firms will require a strongly concerted effort by the agency charged with this responsibility.

The Department of External Trade's potential role in promoting these backward linkages is twofold. From the start, the department can assist in the identification of local firms that can provide basic services to the EPZ and its users. These services may include janitorial workers, security firms, or landscaping companies. Increasingly in EPZs throughout the world, private firms are responsible for the provision of such basic services. Should the final configuration of Kenya's EPZ program allow for a similar private role, this would be a key area of initial focus by the Department of External Trade. The use of local firms for such activities has an additional advantage in that it spreads the benefits of Kenya's EPZ program to companies unable to operate in the EPZ directly.

Over the medium- to long-term, the department can also seek to foster the local provision of basic inputs. The department can help to facilitate such supply relationships by identifying and aggregating the requirements of EPZ industries, by bringing these requirements to the attention of local manufacturers, and by providing EPZ firms with information and assistance in identifying local suppliers of production inputs. The Korean export promotion agency, KOTRA, for example, maintains a computerized data base with the names of more than 10,000 domestic suppliers and over 70,000 foreign buyers. The small- and medium-sized firms in the Kenyan Industrial Estates program already produce a variety of products which could potentially be used as inputs for EPZ firms, and the GOK may want to initially focus its efforts in identifying these products and firms and compiling a similar data base. Such a focus would both extend the benefits of the EPZ program to a broader segment of the economy, and would be consistent with the GOK objective of promoting indigenous Kenyan businesses. In order to improve the quality and reliability of local manufacturers, seminars should be organized or technical assistance should also be obtained on such subjects as pricing and quality control.

c. EPZ Operators

Once Kenya's EPZ program is established, individual EPZ operators will be required to assume some responsibility for EPZ marketing and promotion. Typically, the responsibilities assumed by zone operators include preparation of the basic promotional literature describing the zone's infrastructure and the costs of basic production factors; the lease or purchase price for standard factory building (SFB) space; lease terms and conditions; and the availability and cost of support services. EPZ operators will also play a key role in facilitating visits to the zone by prospective investors, including the

arrangement of meetings with key government officials and other investors already operating in the EPZ.

Close coordination will be necessary between the EPZ developers/ operators and the IPC. The IPC must be fully knowledgeable about all aspects of each EPZ's infrastructure package. Similarly, the IPC must be kept up to date as to the current amount of SFB space available, the total number of tenants in the EPZ, and the current lease terms and conditions so that IPC can provide accurate information on the EPZ program to interested investors.

In some countries, individual EPZ operators initiate direct contacts with prospective investors, both at home and abroad. It is recommended that, at least in the early stages of EPZ development in Kenya, this function should be left to the IPC. Zone operators should be encouraged, however, to participate in all promotional events that promote Kenya's offshore manufacturing program.

The most important contribution that EPZ operators can make to EPZ promotion in Kenya is to ensure that initial EPZ investors are satisfied with zone operating conditions and procedures. Surveys of EPZ investors have shown that the endorsements (or complaints) of existing occupants are the single most important element influencing investors to invest in an EPZ. Accordingly, both individual EPZ operators as well as GOK regulatory authorities should make every possible effort to ensure that initial EPZ investors receive the best possible treatment.

2. Targeting the Promotional Effort

An important aspect of Kenya's EPZ promotion strategy will be the targeting of priority industry sectors and groups of investors for marketing and promotion activities. Once industry sectors are identified, promotional messages should be developed which illustrate the advantages of the Kenyan EPZ program to those industry sub-sectors. The same holds true for targeting of geographic regions (e.g. the Far East) which offer high potential as sources of EPZ investment. The market analysis in Chapter 4 provides considerable information that will be helpful to GOK authorities in the development of a market strategy. In order to maximize resources, it is important that the industries targeted should not already be ones that are the focus of other specialized government or private sector organizations.

One important question relating to targeting promotion is the degree to which marketing and promotion activities are directed towards foreign as opposed to local investment. In terms of regulatory treatment of investment (incentives, benefits, reporting requirements, etc.), countries that have been most successful in developing dynamic EPZ programs have tended to make no distinction between local and foreign investment. Nonetheless, many countries have mistakenly focused their active promotional efforts primarily on foreign investors.

While EPZs have, in fact, proved to be an effective catalyst for attracting foreign investment in many countries, local investors also can play an important role. In many cases, foreign investors view trends in local investment as a barometer of the country's investment climate as a whole. If there is little local investment in export-oriented manufacturing, foreign investors may view

this as prima facie evidence that there are major obstacles to successful export production. Conversely, evidence of successful local export manufacturing operations can help to allay any concerns held by potential foreign investors with regard to the feasibility of meeting international price and quality standards from a Kenya-based manufacturing operation.

Thus, in addition to publicizing the attractive policy and incentive package offered by the Kenyan EPZ program, promotional efforts should also highlight the country's well-developed manufacturing base, good infrastructure, and support services. Efforts should also be made to differentiate investment conditions in Kenya from those prevailing elsewhere in Africa. The best way of conveying this message will be to point to existing investments which have been successful in producing for the international market.

In targeting investors, the IPC and EPZ operators should also focus on the advantages inherent to a Kenyan manufacturing location. Asian firms will be attracted by Kenya's preferential access to the EC market, and the absence of quotas on apparel exports to the United States. In order to attract U.S. firms, Kenya should be portrayed as a prime location for accessing the post-1992 EC market, in addition to the 20 countries and 180 million persons potentially accessible under the PTA agreement.

Another potential source of investment which should be the focus of targeting efforts may well be Mauritian firms. Companies operating in Mauritius are currently facing labor shortages, rapidly accelerating wage rates, and market access problems for garment exports to the European Community. In its promotional efforts to these firms, Kenya should stress labor availability and cost, transportation links to Europe and East Asia, and quota-free access to the U.S. market. In addition, Kenya should consider promoting "production sharing" arrangements between Mauritius and Kenya, whereby, cutting might be done in Mauritius and sewing and packaging done in Kenya.

3. Marketing Approach

The effective marketing of Kenya's EPZ program requires the selection of the most appropriate marketing and promotional techniques, in combination with the development of the most effective promotional materials. There are two general types of promotional activities which are typically incorporated into EPZ promotion strategies. The first set of activities are designed to position a particular EPZ location within the minds of potential investors. This is most often accomplished through advertising and placement of articles in general business publications, or through participation in conferences and other programs.

The second set of activities are much more targeted, and are undertaken with the objective of initiating direct contact with prospective investors. These activities include direct mail, telemarketing, and selective advertising in specialized magazines catering to specific industry sectors, as well as participation in specialized trade shows.

Selection of an appropriate mix of general and targeted promotion must be based on a clear understanding of the advantages, disadvantages, and costs of each technique. Procedures should be established to facilitate the careful monitoring of the cost effectiveness of alternative techniques. A variety of potential techniques can be utilized. Brief assessments of the various marketing techniques that are frequently utilized in EPZ promotion are presented below.

a. Promotional Materials

One of the basic tools required by any promotional organization is information and marketing materials. Typically, EPZs provide interested investors with a package of materials which includes both general investment promotion brochures and brochures describing individual zones. As noted above, the IPC's existing promotional materials will need to be revised or augmented to increase their attractiveness and conciseness, and to include information relevant to the EPZ program. In addition to developing basic brochures describing their zone(s), individual EPZ developers should also be encouraged to produce attractive folders, in which to place a variety of materials or pamphlets which will comprise the complete information package

In developing promotional materials, it is suggested that Kenyan EPZs be judicious in the use of color. Four-color printing is very expensive -- the cost often runs 4 to 5 times higher than that for a single color. As result of the cost involved in reprinting color brochures, many promotion agencies often fail to update materials with sufficient frequency. For serious investors, it is highly preferable to receive a brochure that is current in its information, rather than to receive one which is highly attractive but is short on accurate information. A reasonable compromise used by many promotion organizations is to print four-color folders, while limiting information materials to simple one-color pamphlets or brochures in order to facilitate frequent updating. Advances in desk-top publishing technology make this approach particularly feasible; as seen above, the IPC/DR in the Dominican Republic produces all its promotional materials in this manner.

b. Advertising

The cost-effectiveness of advertising varies widely, depending on the media and publications selected. For general image building purposes, an occasional advertisement in a general business publication such as the London Financial Times or the U.S. Wall Street Journal may be of some use, although these publications tend to be costly (for example, a full-page advertisement in the Journal costs US$40,000. For budgetary reasons, nearly all EPZ advertising is limited to the print media, and is most commonly targeted through specialized industry journals such as Bobbin magazine, which serves the textile and apparel industry. Advertisements in targeted industry publications generally are much less expensive -- a full page advertisement in Bobbin costs US$1,890 -- and actually produce much better results because they reached a specialized audience.

The IPC/DR in the Dominican Republic maximizes its advertising budget by tracking the response rate to advertisements placed in specialized trade journals. After

noting the high rate of response from electronics firms in one geographical region of the U.S., the IPC then sought a specialized journal whose readership was concentrated in that region. An advertisement placed in that journal has been one of the most effective and least costly advertising campaigns utilized by the IPC/DR. Such techniques illustrate that targeted advertising is the most effective form of advertising and needs not be costly to be highly efficient.

c. Public/Press Relations

Arranging for positive news coverage and/or the placement of favorable articles is a much more effective (and less costly) use of the media than is paid advertising. Both the IPC and individual EPZ developers should develop and maintain close contacts with local and foreign publications and journalists, providing them with press releases announcing progress in EPZ development along with announcements of new investments. As much as possible, public relations efforts should be built around positive, visible changes or events. A positive press campaign is particularly important for a Kenyan EPZ in order to help offset the negative press coverage regarding the country's investment climate that has been prevalent in recent years.

Particularly during the developmental stages of the Kenyan EPZ program, the press should be engaged as much and as often as possible to highlight specific steps toward enhancing incentives, streamlining approval procedures, improving transparency, etc. Only by highlighting positive changes will Kenya be able to counter the negative perception of the country that exists in the minds of many foreign investors. Specific milestones which can and should be publicized will include: enactment of EPZ legislation; inauguration of EPZ(s) and groundbreaking ceremonies; new investment or expansion announcements by recognized firms; start-ups of new manufacturing operations; visits by important persons; and measurable increases in employment and manufactured exports. All of these developments should be publicized through press releases and promotional events.

d. Business Conferences/Trade Shows

These types of events allow EPZ promoters to make multiple personal contacts. The best way to make effective use of such conferences, from a marketing perspective, is to arrange to be included as a conference speaker or panelist. Depending on the focus of the show, an exhibition booth can also be an effective marketing tool, although mobilizing and staffing a booth at a trade show can sometimes be an expensive proposition; it is estimated that US$6,000 would be needed to staff and equip an average-sized booth at an investment conference.

e. Investment Missions/Seminars

If carefully planned and followed up, investment seminars can be an effective way of making direct contact with a large number of prospective investors. On the other hand, a poorly organized seminar can be counterproductive, in that it may tarnish a country or EPZ's image. An effective overseas seminar generally

requires 4 to 6 months preparation time, in addition to a substantial commitment of professional and administrative staff time.

An useful promotion approach which is highly convincing is for a current, satisfied foreign investor to host an investment seminar in their country of origin. Businessmen who are successfully operating in the country are usually good advocates for the host country investment climate. Such seminars have much higher credibility than those offered through the host country's embassy or overseas trade offices.

Another key to a successful investment seminar is careful screening and pre-seminar contact with attendees. Typically, only a small percentage of those who register or accept invitations to investment seminars are bonafide investors. The remainder are consultants, students, representatives of firms hoping to sell goods or services in the sponsoring country, etc. Pre-seminar contact with registrants enables the promotion agency to identify serious investors, to prepare in advance answers to specific questions, and to provide any additional information that may be required by potential investors.

f. Site Visit Assistance

Site visits are one of the most important opportunities to "sell" an EPZ site to a prospective investor. The key to an effective site visit is proper planning and attention to logistical arrangements. Prospects should be met at the airport; hotel accommodations should be arranged well in advance; and appointments should be confirmed and reconfirmed. Careful attention should be paid to determining the prospective investor's specific interests and schedules should be arranged accordingly.

The initial portion of the visit should be coordinated by the IPC, which should be the investor's first stop. Only after the IPC provides an overview of investment conditions, policies, and procedures, should the prospect be taken by the EPZ developer(s) to visit the zone. If more than one EPZ is in operation, it is critical that the investor be given the option of visiting multiple zones. In addition, it is important that visitors be introduced to current EPZ tenants, or other investors in Kenya. If possible, at least one of these tenants should have the same nationality as the prospective investor so they can discuss the zone and investment climate in their native language.

h. Investor Follow-Up

Both the IPC and individual EPZ operators should develop systems to ensure adequate follow-up of meetings with prospective investors. Market research indicates that, on average, eight contacts with a prospective buyer are needed to close a sale. This figure has proven to be equally applicable to EPZ promotion as to consumer product marketing. In the Dominican Republic, for example, a computerized tracking system has been developed to ensure that all investor leads generated by mail campaigns, trade fairs, investment seminars, or advertising campaign are pursued. This system automatically notifies investment counsellors when the time has arrived for sending a follow-up letter

or making a telephone call, thereby ensuring that all such letters and calls are generated on a timely basis.

4. The Stages of EPZ Promotion

The design of a truly effective promotion strategy for a Kenyan EPZ begins with the successful development and passage of the free zone enabling legislation and the introduction of an incentives package and administrative environment which is highly competitive. It is important to remember that no promotional campaign -- no matter how expensive, well designed, or well coordinated -- can overcome basic inadequacies in the EPZ package itself. A poor incentives structure, the failure to create what is truly a one-stop-shop or to reduce bureaucratic paperwork, will create negative publicity that will undermine any promotional strategy.

The design and passage of the EPZ legislation is therefore the starting point for a Kenyan EPZ promotional strategy. As discussed in the implementation plan in Chapter 9, a number of sequential promotional steps can then be undertaken. The IPC's promotional literature should be revised to incorporate details of the EPZ program and incentives. Passage of the EPZ legislation should be advertised through preparation of press releases, and detailed information should be circulated to local foreign embassies and to GOK embassies abroad regarding the detailed implementation timetable for the EPZ.

In the next stage, a comprehensive EPZ demand survey should be undertaken in Western Europe, the United States, and East Asia to identify potential foreign investors. In this stage, the Department of External Trade can also begin to identify local firms with the capabilities to provide subcontracting services.

Once a specific EPZ site has been selected, the IPC can begin to prepare zone-specific brochures. Drawing upon the results of the EPZ demand survey, the IPC can begin to target investment promotional efforts toward those industry sectors and geographical regions which were shown to have the highest potential as sources of EPZ investment. Preparation of the press and public relations campaign can be initiated, including the identification of those specialized trade journals most suitable for advertising efforts.

Finally, once all these promotional preparation efforts have been completed and EPZ development commences, the full press and public relations campaign can be launched, including distribution of zone brochures and the organization of investment seminars, in the key countries for prospective investors. It is important that these steps be taken sequentially, not only in order to ensure that the promotional strategy is carefully and comprehensively developed, but also to ensure that promotional efforts always keep apace with actual EPZ developments.

ANNEX C

INSTITUTIONAL ASSESSMENT OF THE CUSTOMS AND EXCISE DEPARTMENT

ANNEX C

INSTITUTIONAL ASSESSMENT OF THE CUSTOMS AND EXCISE DEPARTMENT

The control, valuation, and monitoring of the entry and exit of merchandise across Kenyan borders involves a number of government institutions, including the Ministry of Commerce, Central Bank, Police Department, and Kenya Ports Authority. Principal responsibility rests, however, with the Customs and Excise Department of the Ministry of Finance.

The Customs and Excise Department was established to supervise the implementation of the Customs and Excise Act (Cap. 472). This Act of Parliament provides for the "management and administration of Customs, for the assessment, charge and collection of Customs and Excise duties and for matters relating thereto and connected therewith." On the private sector side, there are large numbers of importers and exporters, clearing and forwarding agents, insurance companies, and freight firms involved in transnational commerce and its facilitation.

A. ORGANIZATIONAL STRUCTURE

1. Overview

Policy matters and procedural guidelines for Customs are established by the Ministry of Finance. The Commissioner of Customs and Excise, who is appointed by the Public Service Commission, is the functional equivalent of a Ministerial Head of Department. The Commissioner reports to the Minister for Finance, and is assisted by a Deputy Commissioner of Customs and Excise.

The Customs Department is not a policymaking body itself, but administers the policies established by the Ministry of Finance with regard to international commerce. The Customs Department is separated into four divisions, along functional (Revenue and Administration) and geographic lines (Northern Region and Southern Region).

Customs clearance procedures fall within the domain of the Revenue Division, as carried out by Customs officials throughout the country. The Revenue Division is the technical branch of the Customs and Excise Department, and is responsible for the application of Customs tariffs, Customs laws, enforcement, valuations, budgetary matters, and revenue performance discipline. The Administration Division is responsible for personnel, administration, and Discipline, and is also concerned with all matters relating to training.

The Northern Region Division covers all of Kenya, with the exception of the Coastal Area, and is administered from Nairobi. The Southern Region Division

covers the coastal areas and is administered from Mombasa.[1] The Coastal Region is currently being linked to Nairobi by an on-line computer system. This system is scheduled to be completed by mid-1990.

2. Jurisdiction

The Customs Department is responsible for the monitoring of activity at all international ports of entry into Kenya. Ports of entry are those locations designated by the Commissioner of Customs as lawful passageways for the importation and exportation of goods. These locations include seaports, airports, border stations, and post offices, as specifically defined in the Customs and Excise Act. It is important to distinguish between a port of entry for persons, which is the responsibility of the Department of Immigration, from a port of entry of goods, which is the responsibility of the Department of Customs. In most cases, however, Customs would have the responsibility for controlling the entry into Kenya of all persons in order to prevent the illegal importation of merchandise.

The ports of entry, as defined in the Act, include:

(i) Ports for vessels: Kilifi, Lamu, Malindi, Kilindini, Old Port, and Shimoni;
(ii) Frontier Ports: Garissa, Moyale, and Wajir; and,
(iii) Customs Airports: Kisumu, Moi Airport, Jomo Kenyatta Airport, W. Wilson Airport, Eastleigh Airport, and Malindi.

In addition, ports of entry for limited or special purposes, such as the Inland Container Depot in Nairobi, are also specified in the Act.

3. Personnel and Staffing

The Customs Department has a staff of approximately 2,500 employees, and is one of the largest functional divisions within the GOK; the Department is, in fact, larger than many Ministries. Approximately 1000 Customs personnel serve the Coastal Region. (A table displaying the staffing of the Customs Department is appended to this Annex).

Each division is headed by a Senior Assistant Commissioner of Customs. In addition there are eight Assistant Commissioners. Two Assistant Commissioners head smaller Investigation and Inspectorate divisions. A third is seconded as a Customs Adviser to the head office of the Preferential Trade Area for East and Southern African States (PTA) in Lusaka, Zambia; another heads the Customs Training School; and one Assistant Commissioner is head of the Customs Office in Kisumu. The other three work at Customs Headquarters.

---

[1] The jurisdiction of the Southern Region includes the ports of entry at Kilindini; Moi Airport, Mombasa; Malindi; Lamu; Kilifi; Shimoni; Taveta; Kiunga; and Lunga Lunga.

Below the Senior Assistant Commission level, there are three major areas of staff. There are 18 Principal Collectors who serve as senior level managers for the various Customs districts or "collectorates." These managers report directly to Customs Headquarters in Nairobi. They are supported by a number of lower grades and levels of collectors, examining officers, and their assistants. The Principal Collectors have more than 600 supporting employees, located in geographical posts throughout Kenya. The principal responsibility of these employees is the inspection and valuation of transborder merchandise.

A second functional staffing area within the overall organizational framework is the Customs Preventive Service. This service is staffed by more than 100 officers who provide a monitoring and control function at the country's airports, ports, and other points of entry and border areas. They are supported by an estimated 770 guards and assistants. Finally, within Customs Headquarters, there are over 230 technicians (e.g., accountants and statisticians) who are involved in the collection, computerization, and analysis of merchandise trade statistics at a technical and professional level. The support staff for this group, combined with general administrative staff, totals another 750 employees. There is also a small staff located at the Customs Chemical Laboratory at headquarters which is responsible for the chemical analysis of merchandise for the determination of customs classification.

4. Decision-Making Structure

The Customs Act is very explicit with regard to both the responsibilities of the Commissioner of Customs and the Customs Officers. All Collectors are empowered to represent the Commissioner in the collection of Customs duties. Issues of policy, however, are the responsibility of the Minister of Finance, who also retains the power to waive the duty on any good. The Act (Art. 23) also specifies procedures which require the specific authorization of the Commissioner. Under the Act the Commissioner may:

> (a) permit goods to be loaded onto, or unloaded and removed from an aircraft, vessel or vehicle on such days, at such times, at such places, and under such conditions, as he may either generally or in any particular case direct;
>
> (b) permit the entry of goods, and the report or clearance of an aircraft, vessel or vehicle, in such form and manner, and by such person, as he may either generally or in particular cases direct; and,
>
> (c) dispense, wholly or in part, with any requirement imposed on an excise license under this Act.

B. DEPARTMENTAL ADMINISTRATION

1. Recordkeeping

The Customs and Excise Department is not yet fully computerized. The only computerization at the moment involves the entry of trade statistics into a data base, and the total computer staff numbers only six persons. Plans for computerization are currently underway, however, and a budget has been allocated by the Treasury for this purpose. Consultants have also been hired to assist in the design of software systems and to advise on personnel requirements. Following the establishment of a computerized system at headquarters, all the regional offices will then be brought on-line to the same system.

2. Personnel Management

a. Training

The department conducts all training for Customs personnel. Training courses are conducted mainly at the Customs Training School at Mombasa, which has a capacity of 60 individuals. Courses are designed for the needs of different levels of officers, including collectors, examining officers, assistants, preventive officers, and preventive guards. Course duration ranges from three months to two years. Principal areas of specialization during training are: Customs procedures, techniques, and laws; mercantile law; enforcement procedures (including the prevention and detection of Customs offenses); general administration; and the civil service code of conduct. The entry requirements are a first university degree for Collectors, A-levels for Examining Officers, and O-levels for Customs Assistants and Preventive Guards.

The training program combines theory and practice and is considered adequate by the Customs Department. It is believed, however, that there is a need for further, more specialized training courses. Such courses would include short-term studies abroad in specific areas such as valuation, tariff administration, and other Customs procedures and practices. In addition, the training facilities and equipment could be greatly improved.

b. Employee Evaluation and Internal Audits

The Customs Department does not have an employee job evaluation system. There is an internal audit section whose primary responsibility is ensuring that customs collection work is being carried out. The department has recently received directives from the Treasury, however, regarding a new internal audit system which Treasury is considering implementing.

Government audits are carried out by the Auditor-General whose staff is professionally reputable and has demonstrated a thorough knowledge of the Customs Act. The audit reports are contained in the Annual Report and Accounts of the Auditor-General, which is published annually and discussed by Parliament. There is a special Public Accounts Committee of Parliament which examines these accounts.

c. Rewards and Punitive Measures

For all intents and purposes, according to civil service officers, there is no formalized system of reward for good performance and even letters of commendation are seldom, if ever, received. Despite the lack of a formalized system, according to some officers, good performance has at times favorably influenced the promotions of some officers.

The Customs and Excise Act provides in very strong fashion for sanctions and penalties against violators of Customs procedures. These sanctions apply to both Customs Officers and to those who encourage officers to commit offenses. Customs officials are considered guilty of an offense under the Customs Act if they do any of the following:

> "(a) directly or indirectly asks for, or takes, in connection with any of his duties a payment or other reward whatsoever, whether pecuniary or otherwise, or a promise or security for any such payment or reward, not being a payment or reward which he is lawfully entitled to claim or receive; or
>
> (b) enters into or acquiesces in any agreement to do, abstain from doing, permit, conceal or connive at, any act or thing whereby the Customs is or may be defrauded, or which is contrary to the provisions of this Act or the proper execution of the duty of that officer; or
>
> (c) discloses, except for the purposes of this Act or when required to do so as a witness in a court or with the approval of the Minister, information acquired by him in the performance of his duties relating to a person, firm or business of any kind."

Customs officials found guilty of any of these offenses are liable to imprisonment for a term no exceeding three years. Similarly, any individual who directly or indirectly offers a Customs official a payment or other reward to act in a way which violates Customs procedures is also liable to imprisonment for not more than three years.

Under a former system in the Customs Department, any officer who was found to have "failed" to collect, or to have undercollected, Customs duties, would have a surcharge levied upon his salary. Owing to problems which arose with the implementation of the system -- for example, how to determine what percentage of the uncollected duties should be assessed as a fine -- the system is no longer in force.

There is within the Customs Department, however, an Inspectorate Unit which periodically conducts unannounced internal audits. Those officers caught by such an audit are punished, but only after a very lengthy due process. The sanctions apparently applied at present are those provided for under the Civil Service Regulations and Code of Conduct. If an officer is found to have committed an offense, other than criminal misconduct, his case will be reported to the Permanent Secretary. The Secretary would, in turn, refer the case to a Ministerial Advisory Committee, which would then be responsible for summoning the offending officer. The Committee would have responsibility for determining

the nature and extent of the penalty should the officer be found guilty of misconduct. In cases of criminal misconduct, the officer would be reported to the police.

C. THE MANUFACTURING-UNDER-BOND PROGRAM

1. Overview

The legislative and administrative framework for Customs procedures for the Manufacturing-Under-Bond (MUB) program are provided for under Legal Notice No. 235 of the Customs and Excise Act (Cap. 472), entitled The Customs and Excise (Remission) No. 37 Order, 1988. The Order was issued by the Minister of Finance on June 16, 1988.

The notice states that "the whole of the import duty payable on machinery, equipment and raw materials imported by a person licenced to manufacture goods for export under bond is remitted." The notice describes in detail the procedures, documentation, fees, bonds, and other regulations required for administration of the scheme. While this provision was legally effective as of the day it was issued, it did not become effectively operative until the first MUB firm began production.

A bonded factory consists of any premises licensed by the Commissioner of Customs for the manufacture of goods under bond. Manufacture-under-bond refers exclusively to the production of goods for export under a licenses issued under the Customs and Excise Act.

2. Customs' Role in Export Promotion Programs

The Customs Department plays an integral role in the MUB program, but is also involved in the Export Compensation scheme. For the latter scheme, Customs is responsible for reconciling exporters' documents with those of exporters' banks. Working with the Central Bank, Customs determines the "accepted value" of exports; this sum is the basis for compensation under the program.

The Customs role is more significant for the MUB program. MUB customs procedures are operated under a section at the Customs Department which is headed by a Principal Collector, assisted by a Senior Collector and various Customs officials. The department is responsible for ensuring that factory premises are built and secured to meet Customs bonded warehouse requirements. In addition, Customs must provide a resident customs officer and a number of preventive guards for each MUB site. These are supervised by an examining officer. The Department of Customs is responsible for the salaries, discipline, and supervision of these officers, although each firm must provide transport for the Customs representatives and pay any overtime costs.

The bulk of the work of the resident Customs Officers is to control receipt of raw materials and equipment from port to factory; to supervise the movement of raw materials from factory stock room to the factory production area; to supervise the movement of manufactured exports from the production area to the

warehouse; to supervise the movement of exports from factory to port of exit; and to supervise the lestruction of factory rejects.

At the port of entry, goods imported for MUB factories must be covered by a security bond equivalent to the duty and sales tax they would have yielded if not covered by the scheme. The goods are then sealed and accompanied to the factory warehouse by a Customs Officer, who must ensure that materials are all unsealed and stored immediately in the Material Stock Room. After this process is completed, the imports bond may be redeemed. The Stock Room is secured by two rocks, one for the Customs Officer and one for the factory owner/manager; both individuals must be present when materials are removed from the stockroom to the production room and entered into the Customs Register at the factory.

Almost exactly the same procedures have to be followed during the "outflow" of goods from the production area; to the locked and guarded factory warehouse, to sealed container, and finally to port of exit. As with the imported raw materials, export goods must also be covered by a security bond which is redeemable after certification is received that goods have left the country.

CUSTOMS AND EXCISE DEPARTMENT: STAFFING AND FUNCTIONS

Title	Number of Employees	Functions
Principal Collectors	18	Head "collectorates" similar to income tax districts (e.g., Jomo Kenyatta Int'l Airport or Kilindini Harbor). Report directly to headquarters.
Senior Collectors	31	Responsible to Principal Collectors; sometimes head stations such as border posts and post offices.
Collectors	63	Divided into Collectors Grades I and II.
Examining Officers	126	
Assistant Examining Officers	112	
Customs Officers	80	
Customs Assistants	200	
Customs Preventive Services		
Customs Preventive Officers	6	Equal to Senior Collectors in rank. Responsible for personal goods (e.g., as brought through airports); sometimes operate under Principal Collectors
Preventive Officers, Grades I & II	45	These four categories of employees are responsible for guarding Customs areas, gates, borders, etc.
Assistant Preventive Officers	56	
Preventive Assistants	70	
Preventive Guards	700	

Customs Chemistry Laboratory

Chemists	6	Analyze goods to verify their chemical composition and thus establish the correct Customs classification.

Support Staff

Accounts Staff	120	Headed by a Senior Accounts Controller who reports to the Commissioner of Customs; responsible for all administrative and Customs accounts.
Statistical Officers	100	Collect and analyze trade and Customs statistics.
Computer Personnel	6	Includes one chief analyst, two computer programmers and several operators. Assist in the digitization of trade statistics.
Supply Officers	12	Supply acquisition and purchase.
Other Support Staff	750	

ANNEX D

MODEL EPZ CUSTOMS PROCEDURES

ANNEX D

MODEL EPZ CUSTOMS PROCEDURES

The following model guidelines are a summary of operating procedures for Customs management of export processing zone operations using the concepts discussed in the main body of the report and, to the some extent, using existing Customs procedures with a minimum of revision.

Arrival/Release Procedures

I. Upon arrival at a Kenyan port of entry, merchandise will be held under Customs supervision without inspection or examination until proper documentation is provided to Customs by the consignee, owner or their agent.

A. In order to gain the release of merchandise destined for an export processing zone, a properly prepared and authorized export processing zone entry declaration must be presented to the Customs officer at the port where the merchandise is detained.

B. As discussed below, the government may require the consignee to submit a properly prepared guarantee for the transportation of the merchandise to the export processing zone facilities.

C. Upon the receipt of a the export processing zone declaration, the authorized supervising Customs officer will immediately place a Customs seal on the merchandise container/package and release the merchandise into the authority of the consignee, owner, or designated agent.

II. Merchandise Inspection at the Port of Arrival

A. Inspection of the merchandise will be postponed until the merchandise arrives at the designated export processing zone operator/user's facilities.

B. The deferral of merchandise inspection and examination at the port of arrival is a privilege provided by the government to all export processing zone operators/users who have not violated pertinent laws and regulations and who have not otherwise demonstrated a lack of competency and trustworthiness.

III. Transportation to the Designated Export Processing Zone

A. Until the merchandise arrives at the EPZ destination, the consignee or owner assumes all responsibilities for assuring the safety of the merchandise and will be required to pay all duty, import taxes, and

any assessed fines and penalties on merchandise which does not arrive at the export processing zone.

IV. Export Processing Zone Entry - Authority to Enter and Documentation

A. A copy of the zone entry declaration will be presented to the Customs official supervising the designated export processing zone facility to document the arrival of the merchandise at the export processing zone.

B. At the discretion of the government and according to the government's determination of the competency and trustworthiness of the EPZ user receiving the merchandise, the government may require the user to place a guarantee, backed by a reputable third party approved by the government, that the user will see to the safety of the merchandise while it is in the export processing zone and agrees to pay the government for all duty, import taxes, fines and penalties for merchandise which has not been officially transferred from the zone and is subsequently discovered to be missing.

C. At the discretion of the government, the export processing zone guarantee may also be submitted at the time the export processing zone declaration is first submitted to Custom to gain release of the merchandise from Customs custody at the port of arrival.

D. Upon proper authorization on the export processing zone declaration by the supervising Customs official, the merchandise will be allowed entry into the export processing zone facility.

V. Export Processing Zone Entry - Inspection and Examination

A. Upon arrival at the designated user facilities within the zone boundaries, the merchandise will be held until the supervising Customs official authorizes the breaking of the Customs seal and the opening of the container/packages.

B. At the discretion of the supervising Customs officer, a Customs inspector may be present during the container opening and unloading to authorize the breaking of the seal, to supervise the opening and unloading of the container, and to inspect the merchandise to verify conformance with supporting documents.

VI. Zone Inventory Control - User Responsibility

A. The designated zone user will be responsible for all merchandise entered into its EPZ facilities and will be liable for duty, import taxes, fines and penalties for any merchandise determined to be missing or discovered to have exited the zone without proper documentation and approvals.

B. Operators/users will maintain complete records of zone merchandise arriving and departing their facility and will assure that such records agree with information reported to the government on export processing zone declarations.

C. Operators/users will maintain complete inventory records of zone merchandise remaining in their export processing zone facilities. Such records will include:

- the quantity, description, and zone declaration number of material on-hand in the same condition as entered into the zone;

- the quantity and description of merchandise produced from material entered into the zone and the zone declaration number of the entered material used to produce the merchandise;

- the quantity and description of material consumed or wasted in the production process with appropriate segregation of waste into valuable and non-valuable waste; and,

- the specific zone location of all zone accountable material and manufactured merchandise.

D. Operators/users will provide authorized government officials immediate access to all records and documents associated with zone accountable merchandise and materials.

VII. Zone Inventory Control - User Reporting Requirements

A. As directed by authorized government official regulations, users will provide periodic reports of zone operations, including summary reports of material entering the zone, consumed in manufacturing, merchandise resulting from production, losses and waste incurred in manufacturing and material/merchandise transferred from the zone for export or, if allowable, for entry into the country for consumption. Such reports will be related to and reconciled with the appropriate EPZ declaration by declaration number.

VIII. Zone Inventory Control - Customs Supervision

A. At the discretion of the supervising Customs officials, periodic inventory reviews and document examinations will be carried out to verify the quantity of EPZ merchandise in zone facilities. The results of such reviews will be compared to appropriate export processing zone declarations, reports submitted by the user, and records required to maintained by the user.

146

IX. Zone Physical Controls

A. In cases of physically controlled, geographical zone facilities, Customs or otherwise designated government or private security organization, will assure that fenced EPZ areas are protected against improper intrusion and unauthorized transfer of zone merchandise through the use of:

- guards at strategic locations;
- limited personnel access to zone facilities through controlled entrances and with proper authority and reason; and,
- properly prepared and authorized documentation to remove merchandise from the facility.

B. In cases of private zones (zones operated by private operators/users on their own premises, also referred to as "licensed factories" or "bonded factories") where the government has authorized the user to physically protect zone merchandise, the authorized user will establish designated areas within the facility where export processing zone merchandise will be stored and used. The user will protect these areas with whatever means are appropriate to assure that accountable merchandise is effectively safeguarded.

X. Transfers from the Zone

A. All transfers from the zone will be reported and authorized on a copy of the applicable EPZ declaration upon which the merchandise was originally entered into the zone.

B. When merchandise is ready to be prepared, packaged or containerized in preparation for transfer from the zone, the zone user or designated agent will request permission to load and transfer the merchandise by submitting a properly prepared zone transfer declaration to the supervising Customs official.

C. Upon approval of the supervising Customs official, the zone user may package or containerize the material in preparation for shipment.

D. At the discretion of supervising Customs official, a Customs inspector may be present to examine the merchandise to be transferred and to supervise the packaging and loading.

E. The Customs approved zone transfer declaration with the proper Customs approval will be the authority for the user to remove the merchandise from the zone.

F. If merchandise is to be exported, a Customs seal will be place on the container or package before it exits the zone facilities.

XI. Zone Transfers for Consumption

A. In cases where EPZ merchandise is allowed entry into the Customs territory for consumption, the zone transfer declaration will be accompanied with a entry declaration for consumption prepared in accordance with the applicable regulations and appropriate duty and import taxes will be collected.

XII. Zone Transfers for Export - International Inland Transportation

A. Zone merchandise transferred for export will be shipped to the port of embarkation according to international inland shipping procedures.

B. The zone transfer declaration and Customs approval will constitute the necessary authority for the international inland transportation.

C. Until the merchandise arrives at the port of embarkation, the consignee or owner assumes all responsibilities for assuring the safety of the merchandise and will be required to pay all duty, import taxes, and any assessed fines and penalties on merchandise which does not arrive at the port of embarkation.

XIII. Zone Transfers for Export - Port of Embarkation Procedures

A. EPZ merchandise arriving at a port of embarkation will be placed under constructive Customs custody pending loading on the exporting vessel.

B. The Customs seal will be inspected and, if in order, Customs will allow the container/package to be loaded onto the exporting vessel.

C. If the Customs seal is intact and there are no other discrepancies, the Customs official supervising the port of embarkation will not open the container and inspect the merchandise after it arrives.

D. The deferral of merchandise inspection and examination at the port of embarkation is a privilege provided by the government to all EPZ operators/users who have not violated pertinent laws and regulations and who have not otherwise demonstrated a lack of competency and trustworthiness.

XIV. Export Processing Zone Documentation - Declaration

A. The EPZ declaration will be a multi-purpose form consisting of the following segments.

B. Zone entry declaration - The zone entry declaration will identify the merchandise to be entered into the export processing zone and will accomplish the following actions:

- request and record Customs permission to transfer merchandise from Customs custody at the port of arrival;

- if appropriate, request and record Customs permission to transfer the merchandise under international inland transportation procedures;

- request and record the Customs approval and authorization to enter the merchandise into the export processing zone; and,

- document the Customs inspection of the merchandise at the export processing zone facility.

C. Zone transfer declaration - The zone transfer declaration will identify the merchandise and its disposition -- whether to be exported or imported for consumption -- and accomplish the following actions:

- request and record Customs permission to transfer the merchandise from the zone;

- if applicable, request and record Customs approval to ship the merchandise under international inland procedures; and,

- document the Customs inspection of the merchandise before being loaded and transferred from the zone.

D. Zone Usage Declaration - The zone usage declaration will identify the disposition of accountable zone merchandise through manufacturing activities -- either consumed in manufacturing or which become valuable or non-valuable waste. The declaration will:

- request and record the Customs approval or disapproval to relieve the zone user of the responsibility and liability for the merchandise.

XV. Zone Entry Documentation - Supporting Documents

A. Documentation to accompany the export processing zone declaration will consist of all normal international trade and shipping documents and will include the following as a minimum:

- Commercial invoice
- Bill of Lading (airbill or waybill)
- Packing List
- Certificate of Origin, if required by law or regulation
- Any other commercial documentation which establishes the merchandise identity, quantity, value, source, destination and associated information.

B. "Pro-forma" invoices or other documents will be accepted only in unusual situations and only for provisional use until the final, official documents are made available.

XVI. Zone Entry Documentation - User Responsibility

A. Zone merchandise responsibility is initially assigned by the zone entry declaration which becomes the official government record of accountable merchandise.

B. Relief from accountability can only be established by the submission and approval of zone transfer and zone usage declarations which together must total to the original amount reported on the associated zone entry declaration.

C. Merchandise inventory not transferred through the use of a zone transfer or zone usage declaration can only be relieved from the operators/user's responsibility through the payment of duty, import taxes and any assessed fines and penalties.

D. Zone transfer and usage declarations will be accompanied by copies of the applicable zone entry declaration with appropriate reconciliations of quantities entered, transferred and on-hand in the zone.

ANNEX E

MODEL OUTLINE FOR A KENYAN EPZ ACT AND SAMPLE EPZ LEGISLATION

INTRODUCTION

The purpose of this Annex is to provide additional background information for the Government of Kenya to use in its discussions and design of the EPZ legislative framework. The Annex consists of an annotated outline of a model EPZ law and samples of prevailing legislation from selected other EPZ-sponsoring countries: Mauritius, Jamaica, Togo, and Uruguay.[1]

The sample legislation attached reflects alternative approaches to the legal configuration and content of an EPZ regime. For example, the Mauritian law (1970) extends EPZ incentives to exporters in individual factories as well as to multi-user industrial facilities on a countrywide basis, while the Jamaican Act (1980) applies solely to the Kingston EPZ. The recently passed EPZ law in Togo (1989) as well as the Uruguayan law (1987) allow EPZ developers to provide private infrastructure and services to the users of their projects, and also extend EPZ incentives to these service providers. The Togolese law is particularly innovative in that the regulatory authority it establishes for the EPZ program is an independent, private corporation.

In reviewing the following, it should be noted that current practice in many EPZ host countries is to include in the EPZ law the basic tenets or principles of the EPZ regime, whereas the procedures and practices in support of the program are presented in subsequent "Implementing Regulations." This approach has the benefit of providing a concise document for review by interested parties in the form of the EPZ Act, with the operational elements (e.g., specific application procedures for EPZ designation, enumeration of EPZ Customs procedures, mechanisms for accessing foreign exchange) presented in the accompanying regulations. Alternatively, the content of the Act can be expanded to include a more detailed description of the procedural elements of the regime, supplemented by topical circulars issued by the GOK which outline more technical aspects, should the need arise.

---

[1] While the outline reflects the principles and procedures proposed in the text of this report, it is not definitive or comprehensive, and should be considered in conjunction with the information presented in relevant chapters of the document to which it is appended.

MODEL OUTLINE FOR A KENYA EXPORT PROCESSING ZONE ACT

Section

PART I -- PRELIMINARY

1. Short Title
2. Objectives of Legislation
3. Interpretation

PART II -- ADMINISTRATION OF THE REGIME

4. Establishment of the Export Processing Zone Authority
5. Activities of the Export Processing Zone Authority

PART III -- DESIGNATION OF EXPORT PROCESSING ZONES AND ACTIVITIES OF EPZ DEVELOPERS

6. Designation of Export Processing Zones
7. Export Processing Zone Developers
8. Powers and Responsibilities of Export Processing Zone Developers

PART IV -- ESTABLISHMENT AND ACTIVITIES OF EPZ ENTERPRISES

9. Establishment of Export Processing Zone Enterprises
10. Activities of Export Processing Zone Enterprises

PART V -- BENEFITS ACCORDED UNDER THE REGIME

11. Treatment of Export Processing Zone Imports and Exports
12. Treatment of Domestic Sales to Export Processing Zones
13. Export Processing Zone Regulatory Regime
14. Export Processing Zone Tax Regime
15. Export Processing Zone Labor Regime
16. Other Export Processing Zone Incentives

PART VI -- MISCELLANEOUS PROVISIONS

17. Enforcement and Liabilities

18. Implementing Regulations

KENYA EXPORT PROCESSING ZONE ACT

PART I -- PRELIMINARY

Section 1: Short Title.

Section 2: Objectives of Legislation.

The overall goals of the Act are specified, e.g., to promote economic growth and development, stimulate new investment, facilitate export development, create employment, etc.

Section 3: Interpretation.

Definition of key terminology included in the legislation, such as:

(a) "Export Processing Zone" (EPZ) shall mean a geographic area in Kenya designated as provided in Section 6, outside national customs territory and duly restricted by controlled access, wherein the benefits created by this Act for Export Processing Zones shall apply.

(b) An Export Processing Zone may also consist of an individual business and its facilities, referred to and designated as a "Special Export Processing Zone."

(c) "Private Party" means any individual, partnership, corporation, or other entity, domestic or foreign, which is not a government agency or owned in any part by a government agency.

(d) "Public Party" means any agency of the Government of Kenya, state-owned enterprises and para-public enterprises.

(e) "Export Processing Zone Developer" shall mean a corporation established to develop and administer an Export Processing Zone in accordance with Section 7, and which has been found suitable to serve as such Export Processing Zone Developer in accordance with Section 6.

(f) "Export Processing Zone Operator" shall mean a private party engaged in the management of an Export Processing Zone designated under Section 6, exercising all functions of administration, promotion, control and maintenance of the Export Processing Zone; the Export Processing Zone Operator may be the Export Processing Zone Developer or another private party working under contract to the Export Processing Zone Developer.

(g) "Export Processing Zone Enterprise" shall mean a private party which has been granted a License under Section 9, and which conducts a trade or business, including but not limited to manufacturing, commercial, office, warehousing, professional or other activity, primarily within the Export

Processing Zones established under this Act. An Export Processing Zone Developer and an Export Processing Zone Operator for an Export Processing Zone shall be considered an Export Processing Zone Enterprise.

(h) "Domestic Kenyan Business" shall mean any non-foreign individual, partnership, corporation or other entity conducting a trade or business within Kenya, which is not an Export Processing Zone Enterprise.

(i) "Infrastructure" shall mean a physical structure which facilitates economic or other activity, or protects property, such as roads, bridges, or storm sewers.

(j) "Public Service" shall mean any service which has been provided in Kenya by a government agency.

(k) "Export Processing Zone Import" shall mean any input or service to be delivered to an Export Processing Zone Enterprise within an Export Processing Zone, whether from outside or inside the Kenyan Customs territory.

(l) "Export Processing Zone Export" shall mean any product or service sold by an Export Processing Zone Enterprise and originating in an Export Processing Zone, regardless of whether such export shall pass through Kenya and depart the country outside an Export Processing Zone for shipping or transportation purposes.

(m) "MOF" shall mean the Ministry of Finance.

(n) "EPZA" shall mean the Export Processing Zone Authority as provided in Section 4.

PART II -- ADMINISTRATION OF THE REGIME

Section 4: Export Processing Zone Authority (EPZA).

Establishes the EPZ Authority, defines its legal and corporate structure, specifying the composition of the Board of Directors, its organizational and decision-making structure, the provisions for financing, as well as general operational framework. Specific procedural aspects of the Authority's operations (e.g., terms of office for Board members, grounds for dismissal and procedures for resignation, minimum frequency of meetings) are generally presented in the Implementing Regulations, rather than within the EPZ Act itself.

Section 5: Activities of the Export Processing Zone Authority.

As discussed in the body of this report (Chapter 6), in order for the EPZ regime to function efficiently, authority for its establishment and implementation must be fully vested in the EPZA. The responsibilities of the EPZA should therefore be specified, including: authority to designate EPZs, and to approve applications from private parties seeking to qualify as EPZ Developers,

256

Operators, or Enterprises;[2] establish application and licensing procedures for firms operating under the EPZ program; establish a one-stop-shop for processing of applications; ensure compliance with the provisions of the Act; issue additional rules and regulations, as required; maintain current data on the performance of the program; etc.

This Section should also specify that the EPZA shall not own, develop, manage, operate, contract, lease or otherwise engage in the establishment and operation of Export Processing Zones and/or Export Processing Zone Enterprises in Kenya.

As in the preceding section, the procedural elements of the administrative, information collection and regulatory responsibilities of the EPZA are generally not included in the EPZ Act, but are specified in the Implementing Regulations.

PART III -- DESIGNATION OF EXPORT PROCESSING ZONES AND ACTIVITIES OF EPZ DEVELOPERS

Section 6: Designation of Export Processing Zones.

Specifies the criteria for decisions by the EPZA as to which areas are designated as EPZs and provides general guidelines on designation procedures which will be amplified in the Implementing Regulations, e.g.:

- The EPZA shall independently establish by regulation a procedure by which private parties may apply for Export Processing Zone designation, and apply for an Export Processing Zone Operator's Permit, to be presented in the Implementing Regulations of this Act.

- The EPZA shall automatically designate specified geographic areas within Kenya as Export Processing Zones based solely upon the following considerations:

  (1) each such designation shall be granted only after the establishment of an Export Processing Zone Developer for the zone as specified in Section 7.

  (2) each zone's Export Processing Zone Developer has been approved as such by the EPZA and has received an Export Processing Zone Operator's Permit as specified in Section 7.

Provision for a default mechanism for automatic approval of applications not processed within 30 days of submission should also be specified, as well as procedures for resubmission of applications that are rejected; likewise, the term of the license and provision for (or prohibition of) its transfer.

- The EPZA shall render its decision on the designation of an EPZ within 30 consecutive days from the date on which the application form for an Export Processing ZOne Operator's Permit has been

---

[2] The suggested content of the application form for designation as an EPZ enterprise is presented in Chapter 6 of this report.

- 25

submitted to the EPZA. Should no decision be rendered within the 30-day term, the designation for the Export Processing Zone shall be automatically be approved.

Other key elements include:

- Each such EPZ designation shall remain in force in perpetuity. No other licenses or permits shall be required. The EPZA is delegated authority only to designate an Export Processing Zone and not to independently revoke any such designation, which shall require the authorization of the Office of the Presidency.

- The powers, responsibilities, rights, and benefits granted by an Export Processing Zone Operator's Permit shall be the same as those granted by the EPZ License in accordance with Sections 9 and 10, and all related provisions of this Act.

- Special Export Processing Zones shall adhere to the provisions established herein for EPZ Enterprises, and are not subject to designation procedures described above.

Section 7: Export Processing Zone Developers.

Specifies the rights/requirements for designation as an EPZ Developer in terms of corporate/legal structure, ownership/control of suitable property, etc.:

- Each Export Processing Zone Developer shall be a separately incorporated entity.

- An Export Processing Zone Developer may be established by one or more private parties.

- Each Export Processing Zone Developer must either own or have leased all the land within a proposed zone area.

- An Export Processing Zone Developer may contract a private party to engage in all aspects of management, control and promotion of the designated Export Processing Zone; such parties shall be considered to be Export Processing Zone Enterprises.

- Each zone's Export Processing Zone Developer shall receive an Export Processing Zone Operator's Permit from the EPZA automatically, according to the criteria presented in the form of a standardized, application form as detailed in this Act's Implementing Regulations.

- An Export Processing Zone Developer may sell his interest and rights in the zone to another private party after receiving approval for such sale from the EPZA.

Again, procedural elements are generally detailed in the Implementing Regulations.

Section 8: Powers and Responsibilities of Export Processing Zone Developers.

Sets forth the allowable and mandated activities of the EPZ Developer under the law, e.g.:

- operate EPZ Enterprises (subject to licensing procedures);
- lease, sublease or sell land or buildings to EPZ Enterprises (and to charge rent in the local currency equivalent to a hard currency rate at the official exchange rate prevailing at the time of payment);
- make improvements to the EPZ site and its facilities;
- provide infrastructure and other services;
- maintain adequate security measures;
- provide facilities for Customs services and the on-site EPZA office and to contribute to the cost of such services;
- adopt rules and regulations for businesses within the zone, which shall promote its safe and efficient operation; and,
- maintain adequate and proper accounts and other records in relation to its business and report on zone activities, performance, and developments to EPZA on a regular basis.

This section of the Act should be quite detailed so as to avoid any ambiguity over what activities are within the lawful realm of the EPZ Developer and to explicitly provide the freedom required to ensure the successful development of the project, whatever its configuration.

PART IV -- ESTABLISHMENT AND ACTIVITIES OF EPZ ENTERPRISES

Section 9: Establishment of Export Processing Zone Enterprises.

Specifies the general procedures for obtaining designation as an EPZ Enterprise from the EPZA, basic criteria for evaluation of applications, and procedures to be followed by the EPZA (including default mechanism, as in Section 6, above). As outline below, any private enterprise that will provide goods or services exclusively for the export market should be eligible for EPZ status, provided that it does not have a deleterious impact on the environment, engage in unlawful activities, impinge upon national security, etc.

- The EPZA shall have the sole authority to independently receive, evaluate, and approve applications for a EPZ License (and modifications to an EPZ License) and to issue such Licenses, to enterprises qualifying as Export Processing Zone Enterprises. An EPZ License will automatically be granted by the EPZA if the application is found to meet the objectives of this Act as set forth in Section 2, and if the proposed business enterprise:

  (1) will produce goods and/or services which are for export or sale to buyers who are not residents of Kenya except as provided in Section 10.

  (2) will not have a deleterious effect on the environment.

251

(3) will not utilize or produce the following goods which are not to be taken or stored in an Export Processing Zone: firearms, ammunition and other items of warfare (other than by members of Kenyan Police, Armed forces or by security guards employed to work in an Export Processing Zone in the course of their duties); dangerous explosives; other dangerous or hazardous materials; and illegal drugs and other substances illegal under the laws of the Republic of Kenya;

(4) will be conducted in compliance with all applicable legal and regulatory requirements under the laws of Kenya, and all rules and regulations of the zone established by the EPZA, and the owner or owners of the enterprise have agreed to maintain such compliance.

This Section should explicitly state that the EPZ license is the sole and complete authorization required for a business to qualify to operate as an EPZ Enterprise, and receive all benefits accorded under the Act. Other key elements to be addressed include, authority to lease or purchase land/facilities within an EPZ or to establish as a "Special Free Zone" (case-by-case basis).

Section 10: Activities of Export Processing Zone Enterprises.

Essentially, provides the freedom to undertake any kind of industrial and commercial activities and render any services for the export market, as authorized in the EPZ license, which the EPZA deems desirable for the development of the Kenyan national economy. As outlined in Section 9, illegal, harmful, or undesirable activities are generally specified as prohibited.

This Section should also specify the extent that local sales by EPZ enterprises are to be permitted (subject to all relevant payments and regulations) and the general procedures for obtaining EPZA approval of such sales.

PART V -- BENEFITS ACCORDED UNDER THE REGIME

As discussed in detail in Chapter 5 of the report, the following incentives are recommended for inclusion under the Kenyan EPZ regime and should be specified in the following Sections as extended to all EPZ Enterprises (including users, operators, and developers):

Section 11: Export Processing Zone Imports and Exports.

- freedom from import and export licensing requirements;
- exemption from all existing and future direct and indirect taxes and duties on all EPZ imports including, capital equipment, office furniture, office equipment, construction equipment, tools, spare parts, raw materials, intermediate goods, supplies, consumer goods, motor vehicles, and fuel;
- exemption from all existing and future direct and indirect taxes and duties on EPZ exports;
- exemption from price or margin controls on imports or exports;

- exemption from quotas or import/export prohibitions, with the exception of firearms, military equipment, illegal materials, etc.;
- single, on-site inspection by Customs for imports and exports; and,
- imports into Kenya from an EPZ shall be subject to the current rules and regulations affecting imports into the national Customs territory.

As a general rule, wording should also be included which exempts EPZ Enterprises from any and all taxes, fees, and duties, present and future, that are not expressly mentioned in the law.

Section 12: Domestic Sales to Export Processing Zones.

- freedom from licensing requirements, price controls, and quota restrictions on sales by a domestic Kenyan business to an EPZ Enterprise;
- consideration of all sales by domestic parties residing in the national Customs territory to an EPZ as exports under the laws of the Republic of Kenya, and therefore eligible for all benefits accorded export industries under the applicable existing and future laws;[3]
- specification that payment for such sales will be made in local currency.

Section 13: Export Processing Zone Regulatory Regime.

- EPZ license is the sole license required to conduct an EPZ Enterprise;
- exemption from rent or tenancy controls on EPZ rental property;
- exemption from regulations, restrictions or prohibitions regarding the sale, movement, or purchase of foreign currencies;
- autonomous and independent access to and control over their capital and earnings, and authority to freely maintain foreign currency accounts with any commercial bank within or outside an EPZ;
- expenditures payable in local currency for goods and services procured locally shall be effected in local currency; and,
- freedom from restrictions regarding mandatory sourcing of goods and services.

---

[3] As discussed in Chapter 5 of the report, it is recommended that the GOK consider offering additional incentives to "partial" exporters beyond the existing Export Compensation scheme which would further stimulate linkages between the EPZs and the domestic economy.

261

Section 14: Export Processing Zone Tax Regime.

- exemption from income tax or capital gains tax or any new corporate tax adopted by the Government of Kenya after passage of this Act for a period of 12 years following the date of first tax liability;
- subject to an annual tax of 15 percent on profits thereafter;
- exemption from withholding tax on dividends in perpetuity;
- provision for loss carry-forward if a total net loss over the 12 years of the tax holiday is incurred; and,
- exemption from taxes on property, transfer, sales, foreign exchange etc., in perpetuity.

Section 15: Export Processing Zone Labor Regime.

As outlined in Chapter 5 of the report, only two areas have been identified where beneficiaries of the EPZ regime should be exempted from existing Kenyan labor regulations: (i) restrictions on night-time female employment should be lifted; and (ii) provision should be made for automatic access to expatriate work visas and streamlined renewal procedures. This section should also specify that Kenyan workers will be paid in local currency by EPZ Enterprises and that, apart from the exceptions specified, all other provisions of the Kenya labor regime shall apply.

Section 16: Other Export Processing Zone Incentives.

- exemption from any and all local content requirements;
- permission to use or provide alternative sources of power, water, telecommunications, and other infrastructure and services within an EPZ facility; and,
- preferential port charges for KPA services, as specified by the EPZA.

PART VI -- MISCELLANEOUS PROVISIONS

Section 17: Enforcement and Liabilities.

This Section should outline the authority of the EPZA to levy fines and invoke penalties on firms and individuals operating under the EPZ regime for misconduct. Allowance should be made for revocation of the EPZ license in cases of severe violations. General wording with regard to the right of appeal and referral of disputes to the Kenyan judicial system or to international arbitration should also be included, as well as, provision against GOK expropriation/nationalization of EPZ property. Specific penalties and procedures are generally set forth in the Implementing Regulations.

Section 18: Implementing Regulations.

Simply states that the Government of Kenya shall have the power to adopt all regulations required to implement this Act.

THE EXPORT PROCESSING ZONES ACT, 1970 (MAURITIUS)

THE EXPORT PROCESSING ZONES ACT, 1970

Act No. 51 of 1970

I assent,

8th December, 1970

A.L. WILLIAMS,
Governor - General

ARRANGEMENTS OF SECTIONS

Section

1. Short title
2. Interpretation
3. Export Processing Zones
4. Bonded factories
5. Export products
6. Issue of certificates
7. Amendment of certificates
8. Revocation of certificates
9. Restriction of trading
10. Income Tax relief
11. Duty Relief
12. Removal of scheduled equipment, scheduled materials and export products
13. Payment of duty
14. Employment and labour provisions
15. Publications
16. Power of entry and power to require information
17. Regulations
18. Offences and penalties
19. Consequential amendment
20. Saving clause
21. Commencement

AN ACT

To provide for the setting up of export processing zones, for the issue of certificates to export enterprises, for the operation of such enterprises and for various relief and exemption to be granted to them, and for matters connected therewith or incidental thereto.

ENACTED by the Parliament of Mauritius, as follows -

1. This Act may be cited as the Export Processing Zones Act, short title 1970.

INTERPRETATION

2. In this Act, unless the context otherwise requires -
"adequate security" means security which has been accepted as adequate by the Comptroller for the purpose of Section 11 of this Act;

"bonded factory" means a factory situated in an export processing zone.

"certificate" means an export enterprise certificate issued under section 6 of this Act;

"company" means a company which carries on business or has an office or place of business in Mauritius;

"Comptroller" means the Comptroller of Customs;

/2.....

"duty" means the fiscal, customs or excise duty for the time being leviable under any law in force

"enforcement officer" means a Customs and excise Officer, an officer of the Ministry of Finance or of the Ministry of Commerce and Industry designated in writing by his respective Minister as an enforcement officer for the purpose of this Act.

Ord No. 65 "export" has the meaning assigned to it by section 2 of the Customs Ordinance 1947

"export enterprise" means a company in respect of which a certificate is in force ;

"export processing zone" means any area or building declared to be an export processing zone under section 3 of this Act ;

"export products" means a product or produce in respect of which a declaration has been made under section 5 of this Act ;

Ord No. 65 of 1947 "import" has the meaning assigned to it by section 2 of the Customs Ordinance, 1947 ;

Ord No. 59 of 1969 "manufacture" means a process whereby a resultant finished article falls to be classified under a main heading set out in part I of the First Schedule to the Customs Tariff Act, 1969, which is different from the main heading under which the materials or components used in the process fell to be classified and includes -

(a) the production of any article by the process of mechanical or chemical transformation of any inorganic or organic substance, whether such transformation is carried out by power driven machinery or by manual labour;

(b) the making, processing, altering, repairing, ornamenting, finishing or the breaking up or demolition of any article ;

(c) the assembly of component parts of manufactured products.

Provided that the Minister may by order published in the Gazette declare that notwithstanding the foregoing a certain specific process or a process which results in a specified percentage of value being added to the materials or components used shall also constitute manufacture within the meaning of this section ;

"Minister" means the Minister to whom responsibility for the subject of Commerce and Industry are assigned ;

"Production day" means the day on which an export enterprise commences, or is deemed to commence, its operation ;

"purchase" means the purchase of dutiable goods ex bond whether the goods have been imported or have been locally produced or manufactured

/3.....

Ord No. 84 of 1950

"the Ordinance" means the Income Tax Ordinance, 1950;

"Year of assessment" has the meaning assigned to it by section 2 of the Ordinance.

Export Processing Zones

3. The Minister may, with the object of attracting, promoting or of increasing the manufacture of export products, by notice published in the Gazette declare -

(a) Any area of land on which a factory has been, is being or is likely to be built;

(b) any factory

(c) any area of land which immediately surrounds a factory or the plot on which a factory is being or is likel to be built, to be an export zone.

Bonded factories

4. It shall not be lawful -

(a) to manufacture, pack, unpack orstore goods or to carry carry on any other activity of a commercial or industrial nature in an export processing zone otherwise than in a bonded factory;

(b) except in the case of an export enterprise, to establish, maintain or operate a bonded factory in an export processing zone.

Export Products

5. Where an application in the prescribed form is made to that effect by a company, the Minister may, if he considers it expedient in the public interest so to do, declare any manufactured article, substance matter or other thing or the produce of deep sea fishing (including fresh or frozen fish) to be an export product.

Issue of certificates

6. (1) Where an application in the prescribed form is made to that effect by a company which manufactures or proposes to manufacture an export product, the Minister, may if he considers it expedient in the public interest so to do, issue to the company an export enterprise certificate, subject to such conditions as he thinks fit to impose and declare that the company shall, for so long as the certificate shall remain in force, be an export enterprise.

(2) A certificate shall be in the prescribed form and shall specify:

(a) the production day of the export enterprise;

(b) the tax relief period of the export enterprise, being a period of no less than ten or more than twenty years.

(c) the export product which the export enterprise is orwill be manufacturing;

(d) the capital equipment, machinery and spare parts required by the export enterprise for equipping and operating a bonded factory (hereinafter referred to as "scheduled materials").

266

Amendment of certificates

7. (1) Subject to subsection (2), the Minister may, by notice in writing addressed to an export enterprise, at any time, amend any certificate or any condition attached thereto.

(2) No amendment shall be made to a certificate so as to extend the tax relief period of an export enterprise beyond twenty years.

(3) Where the Minister amends a certificate by substituting for the production day specified therein another earlier or later production day, the provisions of this Act shall have effect in relation to that certificate as if the production day so substituted had been originally specified therein.

Revocation of certificates

8. (1) Where the Minister is satisfied that an export enterprise has contravened or has failed to comply with any of the provisions of this Act or of any regulations made thereunder or any condition attached to a certificate, he may, by notice in writing, require the export enterprise, within thirty days from the date of service of the notice to show cause why the certificate should not be revoked, and if the Minister is satisfied that, having regard to all the circumstances of the case, it is expedient so to do, he may revoke the certificate.

(2) Where a certificate is revoked under subsection (1), the Minister shall specify the date from which the revocation shall become operative and the provisions of this Act shall, from that date, cease to have effect in relation to the certificate so revoked.

(3) Notwithstanding the provisions of subsection (1) the Minister may instead of revoking a certificate direct that the tax relief of the export enterprise shall be restricted to such period as may appear to him to be appropriate.

Restriction on

9. It shall not be lawful for an export enterprise to carry on, during its tax relief period, any trade or business other than in the export product specified in its certificate.

Income Tax relief

10. (1) In any year of assessment, theassessable income, total income or chargeable income of an export enterprise as specified in any statement issued under section 36 FC of the Ordinance and accruing during its tax relief period shall be exempted from tax under the Ordinance.

(2) Any surplus paid by way of dividend to a shareholder by an export enterprise after production day and within the five years next following shall be exempted from tax under the Ordinance.

.. /5

Duty Relief

11. (1) Subject to sections 12 and 13, where an export enterprise imports or purchases any dutiable goods to be used in a bonded factory, no duty shall be paid thereon if they are subject to such conditions as the Comptroller may approve, transported directly and forthwith to a bonded factory and placed there under conditions of adequate security.

(2) The Comptroller may require an export enterprise to enter into a bond in the prescribed form, in such amount as he may determine whereby the export enterprise undertakes to obtain receive keep use or dispose of scheduled equipment or scheduled materials only in strict conformity with the provisions of this Act or of any regualtions made thereunder or with any conditions specified in its certificate.

Removal of scheduled equipment, scheduled materials and export products

12. (1) No scheduled equipment shall be removed from a bonded factory except with the written authorisation of the Comptroller.

(2) No scheduled materials or export products shall be removed from a bonded factory except -

(a) for the purpose of being exported;

(b) for transfer to another bonded factory, with the permission and according to the direction of the Comptroller;

(c) for consumption in Mauritius, with the approval of the Minister and subject to the payment of the appropriate duty;

(d) for destruction in such manner as the Comptroller may direct.

(3) Any person who without lawful authority or reasonable excuse -

(a) removes any scheduled equipment scheduled materials or export product outside a bonded factory;

(b) is found in possession of any scheduled equipment scheduled materials or export product outside a bonded factory; shall commit an offence.

Payment of duty

13. (1) If any time there is in any bonded factory a deficiency in the quantity of dutiable scheduled equipment or materials which ought to be found therein, the export enterprise shall, without prejudice to any other proceedings under this Act, be liable to pay to the Comptroller the duty leviable on the goods not satisfactorily accounted for;

Provided that if the Comptroller is satisfied that the deficiency has been caused by reasonable wastage or unavoidable breakage, leakage, or other accident, he may remit the whole or any part of the duty leviable on the goods found deficient.

(2) An export enterprise shall be required, by notice in writing to pay any duty under this section and the duty shall be paid within thirty days of the issue of the notice.

.../6

-208

Employment and Labour Provisions

14. (1) (a) Every employee shall be employed at not less than a weekly rate of pay.

(b) For the purpose of determining the amount which may accrue to any employee for overtime, for work performed on a public holiday or for the grant of paid leave, or the amount to be deducted in respect of absences, the basic rate per hour shall be deemed to be one forty-fifth of the weekly basic rate.

(2) An employee may be required to work for more than the normal number of hours on any day other than a public holiday and no payment for overtime shall thereupon accrue to the employee if the number of hours of actual work in the week does bot exceed forty five.

(3) (a) An employeed may be required to work in any public holiday.

(b) If an employee performs not less than normal day's work on a public holiday the employer may in respect of the normal day's work, instead of paying the employee at double rate pay him at the normal rate and grant him one day off duty with a normal day's pay in the next following week.

(4) An employee shall not be allowed or require to work for more than seven consecutive days.

(5) An employee who, without his employer's consent or without good and sufficient cause, absents himself from work on a day which immediately precedes or follows a public holiday, shall forfeit one normal day's pay in the next following week or if he is entitled to paid holidays, the amount which would have accrued to him in respect of the next ensuing paid holiday.

(6) A female employee who has at any time had three confinements shall, if one is pregnant thereafter be entitled to maternity leave without pay but shall not be entitled to any maternity allowance.

(7) A woman may be required to work between the hours of ten at night and five in the mornings, but she shall not be required to resume work before a lapse of twelve hours.

(8) Where any employee reckons not less than three years' continuous service with an employer and his services are terminated, he shall be entitled to receive compensation which shall be equivalent to not less than two weeks' wages for each year of service he reckons with that employer.

Provided that no compensation shall be payable in any case of dismissal on grounds of serious misconduct where the employer could not in good faith be expected to adopt any other course than to dismiss the employee.

.../7

Ord. No. 33 of 1963

(9) The provisions of the Termination of Contracts of Service Ordinance, 1963, shall not apply to any contract of employment between an employee and his employer.

(10) For the purpose of this section -

"employee" means any person employed by an export enterprise;

Cap. 214

"good and sufficient cause has the meaning assigned thereto to subsection 5 (c) of section 6 of the employment and Labour Ordinance;

"normal day" means a day of eight hours actual work;

Act No. 22 of 1968

"public holiday" has the meaning assigned thereto in the Public Holidays Act, 1968;

"woman means a female employee who has attained the age of eighteen years;

Publications

(15) (1) Subject to subsection (2), the contents of any application made by, or of any certificate issued to, any company under the provisions of this Act, shall not be published, except at the instance of the company.

(2) The Minister shall cause a notice to be published in the Gazette relating to:

(a) every export product;

(b) the name of every export enterprise;

(c) the issue or revocation of every certificate.

Power of entry and power to require information

(16) (1) Any enforcement officer may, at all reasonable times and, if so required on showing proof of his identity, enter any export processing zone or bonded factory for the purpose of ensuring that the provisions of this Act (other than section 14) and any regualtions made thereunder are being complied with.

(2) Any enforcement officer may require an export enterprise or any person who is a director, secretary or other officer thereof to furnish him with any information touching the business or activities of the export enterprise.

(3) Any person who wilfully obstructs or hinders an enforcement officer acting in the exercise of his functions under this section or, without reasonable excuse, fails or refuse to give to an enforcement officer any information required of him under this section shall commit an offence.

.../8

270

Regulations

17. (1) The Minister may make such regulations as he deems necessary for carrying into effect the provisions of this Act and for prescribing anything that is or may be required to be prescribed.

(2) Any regulations made under this section shall be laid on the table of the Assembly.

Offences and penalties

18. (1) Any person who contravenes or fails to comply with any of the provisions of this Act or of any regulations made thereunder shall commit an offence.

(2) Any person who, in any application, declaration or statement made for the purpose of this act or of any regulations made thereunder, makes a statement which is false or misleading in any material particular, shall commit an offence.

(3) Any person who keeps any record or account relating to an export enterprise which is false or misleading shall commit an offence.

(4) Any person who commits an offence against this Act shall on conviction, be liable to a fine not exceeding ten thousand rupees and to imprisonment for a term not exceeding twelve months.

(5) Where an offence under this Act has been committed by a Company, any person who, at the time of the Commission of that offence, was a director, secretary or other officer of the company, or was purporting to act in any such capacity, shall likewise commit an offence, and, on conviction, be liable to the penalties provided for that offence unless he proves that the offence was committed without his consent or connivance and that he exercised all such diligence to prevent the commission of the offence as he ought to have exercised having regard to the nature of his functions.

Consequential amendment

19. The Schedule to the Industrial Courts Ordinance shall have effect as if the following item were added thereto :

Cap. 183

13. Section 14 of the Export Processing Zones Act, 1970.

Saving Clause

20. The provisions of this Act shall have effect notwithstanding anything to the contrary contained in any of the enactments specified in the schedule to this Act, and save as otherwise expressly provided nothing in this Act contained shall affect the operation of those enactments.

Commencement

21. This Act shall be deemed to have had effect as from the third day of November, one thousand nine hundred and seventy.

Passed in the Legislative Assembly, Island of Mauritius, this second day of December, one thousand nine hundred and seventy.

GUY T. D'ESPAIGNET
Clerk of the Legislative Assembly

271

SCHEDULE

Cap 214	...	The Employment and Labour Ordinance
Cap 397	...	The Companies Ordinance
Ord. No. 42 of 1946	...	The Factories Ordinance
Ord. No. 65 of 1947	...	The Customs Ordinance, 1947
Ord. No. 84 of 1950	...	The Income Tax Ordinance, 1950
Ord. No 6 of 1954	...	The Town and Country Planning Ordinance 1954
Ord No. 71 of 1961	..	The Regulation of Wages and Conditions of the Employment Ordinance, 1961, or any Wages Regulation Order made thereunder.
Act. No. 10 of 1968	...	The Employment of Children, Young Persons and Women Act, 1968
Act No. 59 of 1969	...	The Customs Tariff Act, 1969

THE FINANCE ACT 1980

Act No. 13 of 1980

.....

Section 3 - The Income Tax Act 1974 is amended -

(c) in section 34 by deleting subsection (4) and replacing it by the following subsection -

(4) Subject to subsection (5), where a statement issued under subsection (2) by the Commissioner to an export enterprise showing the amount of its income or loss for a year of assessment has become final and conclusive -

(a) (i) The whole amount of income shown by the statement in respect of any income year during the first ten years of its tax relief period;

(ii) Fifty per cent of the income shown by the statement in respect of any income year falling within the period beginning with the eleventh year to the fifteenth year of its tax relief period;

(iii) twenty five per cent of the income shown by the statement in respect of any income year during the remainder of its tax relief period;

shall not form part of the gross income of the export enterprise for any year of assessment and shall be exempt from tax.

(b) any dividends paid out of the income of the export enterprise which is exempt from tax under paragraph (a) (i) during the five consecutive years beginning with the income year in which the export enterprise resolves to pay dividends to shareholders shall not form part of the gross income of the shareholders and shall be exempt from tax.

.....

.....

Section 9 - The Export Processing Zones Act, 1970 is amended -

(a) in section 6 (2) by deleting paragraph (b) and replacing it by the following:

(b) The tax relief period which shall be a period of twenty years. and

(b) by re-lacing section 10.

THE FINANCE ACT 1985

Act No. 52 of 1985

.....

The Finance Act 1985 (Act No. 52 of 1985) introduced a new section 34C in the Income Tax Act 1974. This section provides for any company holding an Export Enterprise Certificate issued on or after 1 July 1985 to be assessed to income tax at the rate of 15% and for the dividends paid to its shareholders to be exempt from income tax during a period of 10 years starting from its operating or production day.

GOVERNMENT O MAURITIUS

Government Notice No. 13 of 1971

THE EXPORT PROCESSING ZONES ACT, 1970

(Act No. 51 of 1970)

REGULATIONS MADE BY THE MINISTER UNDER SECTION 17 OF THE EXPORT PROCESSING ZONES ACT, 1970

---

1. The Regulations may be cited as the Export Processing Zones Regulations, 1971.

2. All words and expressions used in these Regulations shall have the meanings respectively assigned to them in sections 2 and 6 of the Export Processing Zones Act, 1970 (hereinafter referred to as "the Act").

3. Every application made under subsection (1) of section 6 of the Act shall be in the form set out in the First Schedule to these Regulations.

4. Every certificate issued under subsection (2) of section 6 of the Act shall be in the form set out in the Second Schedule to these Regulations.

5. Every export enterprise shall maintain a record in the form approved by the Comptroller of all scheduled materials received, kept, issued and used, and of all the articles manufactured therefrom, in the bonded factory of the enterprise.

6. (1) Every export enterprise shall enter up daily all records required to be maintained under Regulation 5 and the records shall be maintained in duplicate.

   (2) At the end of each month, every export enterprise shall send the duplicate copy of the records to the Comptroller, to reach him not later than the seventh day of the succeeding month.

7. When and as often as an export enterprise imports or purchases any dutiable scheduled equipment or materials, it shall certify on the Bill of Entry or request note relating to the equipment or materials that they are to be used solely -

   (i) for the establishment, maintenance or operation of the bonded factory of the enterprise; or

   (ii) for the manufacture of the factory.

8. The Comptroller may require an export enterprise to provide information as to the quantities of all scheduled materials used in the manufacture of any article.

9. The Comptroller may at any time require an export enterprise to carry out any operation involving the movement or use of scheduled equipment or materials under the supervision of an enforcement officer.

.../2

JFH

10. (1) Any export enterprise wishing to transfer scheduled equipment or materials from its bonded factory to another bonded factory may apply to the Comptroller for permission to do so in the form approved by the Comptroller.

(2) The written authorisation of the Comptroller shall accompany the transfer of any scheduled equipment or materials from one bonded factory to another.

11. These Regulations shall be deemed to have had effect as from the third day of November 1970.

Made by the Minister on the 24th day of February one thousand nine hundred and seventy one, and ordered to come into force at once.

FIRST SCHEDULE

(Regulation 3)

APPLICATION FOR AN EXPORT ENTERPRISE CERTIFICATE

1. (a) Full name of the applicant company

(b) Registered address of the company

(c) Date and number of certificate of incorporation

2. Business occupation/experience of applicant, with specific reference to this application (with documentary evidence, if available e.g. catalogues, brochures, bank testimoninals, etc.)

3. Description of the export industry it is proposed to establish or develop giving full particulars

4. (a) List of the product(s) and by-products proposed to be produced by the company giving estimates of the quantities and value of each

(b) Quantity and approximate value of raw materials to be used for the periods stated.

5. Markets to which the goods will be exported, as far as possible, by documentary evidence of the availability of export markets

6. Estimated date of Production day

OR

Estimate of the period between issue of Export Enterprise Certificate and Production Day

.../3

8. (a) Where will the industry be established ?

(b) Total area of land required

(c) Proposed built up area

Can the enterprise be accomodated in a storeyed building.

9. (a) Particulars of the loan and share capital of the company including the amount and date of each issue or proposed issue, and the sources from which the capital is to be or has been raised.

(b) Percentage i) of foreign capital

ii) of local capital

10. Names, addresses and shareholding of each Director :-

(i) Name	(ii) Address	(iii) Shareholding

11. (a) Number of persons to be expected to employ in each of the following categories :-

	1 year after production day		2 years after Production Day		5 years after Production Day	
	Mauritians	Expatriates	Mauritians	Expatriates	Mauritians	Expatriates
i) Managerial Staff						
ii) Technical Staff						
iii) Skilled Workers						
iv) Clerical and Office Staff						
v) Unskilled Labourers						

(b) As regards expatriates staff, state full particulars and qualifications or the experience required and indicate when it is anticipated they can be replaced by Mauritians.

(c) As regards Mauritians staff and workers, state approximately the total number of females in each of the 3 cases (i.e 1 year, 2 years and 5 years after Production Day).

12. Details of any other aid than those which the applicant proposes to seek from the Government or any other agency in connection with the enterprise in respect of which income tax relief is now sought :-

13. Requirements :-

Water in gallons per day .....

Electricity : Maximum load in KVA .....

Units per annum in KWA .....

14. Any additional details which may be helpful in considering the merits of the application	

216

11. (b) As regards expatriate staff, state full particulars and qualifications or the experience required and indicate when it is anticipated they can be replaced by Mauritians.

(c) As regards Mauritian staff and workers, state approximately the total number of females in each of the 3 cases (i.e. 1 year, 2 years and 5 years after Production Day).

2. Details of any other assistance which the applicant proposes to seek from the Government of any other agency in connection with the enterprise in respect of which income tax relief is now sought :

13. Requirements :

Water in gallons per day .....

Electricity: Maximum load .....

Units per annum in KWH .....

---

14. Any additional details which may be helpful in considering the merits of this application

---

DECLARATION

I/We hereby declare that the particulars given in this application are to the best of my/our knowledge and belief true and correct, and that any estimates given in this application have been made in good faith and with all due care. I/We further declare that I am/we are fully aware of the provision of Part VIII of the Income Tax Ordinance, 1950.

Signed .....

Designation .....

Signed .....

Designation .....

Dated this ..... day of ..... 19 ....

SECOND SCHEDULE

(Regulation 4)

EXPORT ENTERPRISE CERTIFICATE

WHEREAS the ..... Company Ltd proposes to establish (or participate in) a ..... Industry in Mauritius as described in its application dated ..... and has applied for an export enterprise certificate :

AND WHEREAS the Minister, in accordance with section 6 of the Export Processing Zones Act, 1970 has considered it expedient in the public interest to grant the export enterprise certificate ;

THESE ARE THEREFORE to certify that the ..... Company Ltd is hereby declared to be an export enterprise in terms of the Act with effect from ..... to be known as the date of Production Day, for ..... years.

2. This export enterprise certificate is granted to the ..... Company Ltd subject to the following conditions :

(a) that the company shall be engaged solely in the production of .... hereinafter referred to as export products.

(b) that the company shall start production not later than ..... months after .....

(c) that the scheduled equipment and materials shall be listed in the annexure to this certificate, and that applications for amendment of the list(s) shall be submitted in advance to the Ministry.

(d) that, regarding the employment of labour, the employer shall abide by the following conditions :

i) an employee shall not be made to work overtime for more than 10 hours per week;

ii) privileges for annual leave, sick leave and holidays with pay for male workers shall be at least the same as those prescribed in the Wages Regulation Order for female factory workers (G.N. 180 of 1968).

(iii) in the absence of any prescribed rates and conditions of employment for workers, the Minister of Labour or his duly authorised representative shall, after consultation with the employer, lay down in schedule setting forth fair and reasonable rates and conditions of employment to be observed by the employer, having regard to established rates and conditions in respect of persons employed in a capacity and in general circumstances similar to those of the persons engaged in the export enterprise or, failing such established rates and conditions, any fair standards of rates and conditions commonly recognised in respect of persons employed in a similar capacity and in similar general circumstances.

(iv) The Ministry of Labour or his duly authorised representative may, after consultation with the employer, prescribe the conditions under which employees may retire from employment and the benefits accruing to them in each case.

3. This export enterprise certificate is issued subject to the provisions of Section 8 of the Export Processing Zones Act, 1970.

Dated the ..... day of ..... 19...

Ministry of Industry

.....
Minister

Government Notice No. 266 of 1970

THE EXPORT PROCESSING ZONES ACT, 1970

Regulations made by the Minister under section 17 of the Export Processing Zones Act, 1970

1. These Regulations may be cited as the Export Processing Zones (Amendment) Regulations, 1979.

2. In these regulations -

"principal regulations" means the Export Processing Zones Regulations, 1971.

3. The Second Schedule to the principal regulations is amended by deleting in paragraph 2, sub-paragraphs d(ii) and (iv) and replacing them by the following, the present sub-paragraph d(iii) being renumbered d(iv) :

4. (ii) Every worker shall be remunerated at the rates specified in a Remuneration Order at the time in force and shall be governed by the conditions of employment specified in that order.

(iii) Nothing in the Remuneration Order shall prevent an employer from paying a worker remuneration at a rate higher than that specified in the said order or from providing him with conditions of employment more favourable than those specified in the Order.

Made by the Minister on the 8th November, 1979.

180

KINGSTON EXPORT FREE ZONE ACT, 1980
(JAMAICA)

THE KINGSTON EXPORT FREE ZONE ACT, 1980

(Act 3 of 1980)

ARRANGEMENT OF SECTIONS

Preliminary

1. Short title and commencement.
2. Interpretation.
3. Establishment of the Free Zone.
4. Authority to control, manage and superintend Free Zone.
5. Authority may prescribe activities.

Responsibilities and functions of Authority

6. Functions of the Authority.
7. Ministerial directions.
8. Transfer of property.
9. Funds and resources related to the Free Zone.
10. Borrowing powers.
11. Power of Minister to guarantee loans to the Authority.
12. Repayment of, and interest on, advances and sums issued to meet guarantee.
13. Power to invest funds.
14. Accounts and audit.
15. Annual report.
16. Staff
17. Power to delegate.
18. Protection of members.

Regulations

19. Regulations.

Operations within the Free Zone

20. Approval of enterprise to undertake approved activity

21. Companies to be incorporated or registered locally.

22. Insurance business

23. Dealing with or disposal of goods in Free Zone.

24. Persons not to enter Free Zone without permission.

25. Retail trade.

26. Prohibition on consumption or use of dutiable goods in Free Zone.

27. Special provisions relating to articles imported with customs duty concessions.

28. Restriction upon disposal of articles imported with customs duty concessions.

29. Manufacture or manipulation in Free Zone

30. Allowances for Jamaican labour or materials.

31. Disposal of goods abandoned in Free Zone.

32. Goods not to be taken into or stored in Free Zone.

Licences

33. Import and export licensing.

Banking and foreign currency activities

34. Banking activities.

35. Restrictions on borrowing and payment of employees.

36. Payment for goods and services.

37. Foreign currency accounts and payments in foreign currency.

38. Income tax relief in relation to manufacturing activities.

39. Income tax relief in relation to international trading activities.

Miscellaneous

40. Service charges and dividends subject to exchange control and withholding tax.

41. Approved enterprises to submit returns

42. Commissioner of Income Tax may issue certificates regarding benefits.

43. Work permits

44. Penalty for offences not otherwise provided for.

45. Offences by bodies of persons and by servants and agents.

46. Penalties.

SCHEDULES.

JAMAICA

No. 3—1980

I assent,

[L.S.]

F. A. GLASSPOLE,
Governor-General

21st day of February, 1980.

AN ACT to Provide for the establishment of the Kingston Export Free Zone area, for the operation of the said area, and for matters connected therewith or incidental thereto.

[The date notified by the Minister bringing the Act into operation]

BE IT ENACTED by The Queen's Most Excellent Majesty, by and with the advice and consent of the Senate and House of Representatives of Jamaica, and by the authority of the same, as follows:—

Preliminary

Short title and commencement.

1—This Act may be cited as the Kingston Export Free Zone Act, 1980, and shall come into operation on a day to be appointed by the Minister by notice published in the *Gazette*.

285

Interpretation.

2—In this Act, unless the context otherwise requires—

"approved enterprise" means any enterprise approved by the Authority to carry on an approved activity;

"approved activity" means any activity which may be carried on in the Free Zone in accordance with the First Schedule;

First Schedule.

"the Authority" means the Port Authority established under the Port Authority Act;

"the Chairman" means the Chairman of the Authority or any person for the time being performing the functions of the Chairman;

"customs territory" means Jamaica and the territorial waters thereof but excluding the Free Zone;

"the Free Zone" means the Kingston Export Free Zone area established pursuant to section 3;

"functions" includes duties and powers;

"manufacture" with its grammatical variations and cognate expressions, means the application of any operation or process of converting materials into a new product or article, excluding any operation or process which consists only of one or more of the following—

(a) packing, wherever the packing materials may have been manufactured or produced;

(b) dividing into lots;

(c) sorting or grading;

(d) marking; or

(e) packing into sets;

Establishment of Free Zone.

Second Schedule.

3—(1) There is hereby established the Kingston Export Free Zone which shall consist of the area specified in the Second Schedule.

(2) On the recommendation of the Authority, the Minister may from time to time, by order, amend, vary or add to the Second Schedule, so, howsoever, that at any time when any such amendment, variation or addition is made it shall not prejudice approved enterprises existing at that time.

Authority to control, manage and superintend Free Zone.

4—The Authority shall manage, control, superintend and operate the Free Zone and shall, subject to any restrictions which may be imposed by the Collector-General under the Customs Act, have authority over all goods deposited or manufactured therein, and shall supervise, control and prescribe conditions for the movement of persons, conveyances, vessels and goods into, in and out of the Free Zone.

Authority may prescribe activities First Schedule

5—(1) Subject to subsection (2), the activities specified in the First Schedule shall be approved activities for the purposes of this Act.

(2) The Authority may from time to time, with the approval of the Minister, prescribe the activities which may be carried on in the Free Zone, and for this purpose may, by order, amend the First Schedule.

Responsibilities and functions of Authority

Functions of the Authority.

6—(1) The Authority, in addition to any function or obligation imposed on it under any other enactment for the time being in force, shall—

(a) administer, control, operate and manage the Free Zone and any other property which may from time to time be vested in it under this Act;

(b) provide and maintain such services, facilities and structures as are in its opinion necessary or desirable for the efficient operation of the Free Zone;

(c) permit customs offices to be established in the Free Zone and shall provide facilities for this purpose;

(d) provide adequate fencing and enclosures to segregate the Free Zone from the customs territory;

(e) approve and regulate activities which may be carried on in the Free Zone.

(2) In the exercise of its functions under this Act, the Authority may—

(a) construct and maintain warehouses, factories, commercial buildings, offices, freight-sheds, docking facilities, loading and unloading berths, landings for loading and unloading operations, storage facilities or workshops, ports, piers, shipyards, or other structures for the use of itself or other persons and may grant contracts or concessions to other persons for the construction or provision of any of the said facilities;

(b) sell, rent, grant leases, sub-leases or other interests or concessions in respect of land, buildings or any other facility or structure within the Free Zone owned by, or under control of, the Authority on such terms and conditions and subject to the payment of such price, rental or other consideration as the Authority may think fit;

(c) subject to the provisions of section 21, approve, on such terms and conditions as the Authority thinks fit, persons to carry on approved activities;

(d) import, store, exhibit, pack, unpack, re-pack, manufacture, assemble, refine, purify, mix, transform, operate, re-ship (whether by sea or air), and manipulate all kinds of merchandise, products, raw materials, containers and other commercial goods other than those goods which are prohibited for importation, storage, or manufacture in the Free Zone;

(e) authorize persons, whether national or foreign, resident or non-resident, to carry out the opera-

tions, activities or negotiations specified in paragraphs (a) and (d);

(f) provide water, light and power, telecommunications and any other public utilities or services and enter into contracts for the supplying of the said utilities and services;

(g) develop industrial areas for the manufacture, processing, finishing, re-packing and trans-shipment of products;

(h) subject to the provisions of section 21, with the approval of the Minister enter into joint ventures with any person for the purpose of any approved activity;

(i) carry on or permit to be carried on such other activities as appear to it necessary, advantageous or desirable for or in connection with the exercise and performance of its functions or the operation of a free trade area.

7—The Minister may, after consultation with the Chairman, give to the Authority directions of a general character as to the policy to be followed by the Authority in the exercise and performance of its functions.

Ministerial directions.

8—(1) The Minister may, by order, transfer to the Authority, any property belonging to the Government which appears to him to be necessary or useful to the Authority in carrying out its functions under this Act, and such property shall vest in the Authority by virtue of the order and without further assurance.

Transfer of property.

(2) An order made pursuant to subsection (1) shall—

(a) specify the amount of compensation (if any), payable to the Government in relation to property so transferred and the manner in which such compensation shall be paid;

(b) contain such incidental, consequential or supplementary provisions as the Minister may think necessary or expedient for the purposes of the order.

(3) All property vested in the Authority under this Act shall be exempt from property tax, sewerage rates and all rates imposed under the provisions of Part VII of the Kingston and St. Andrew Corporation Act.

Funds and resources related to the Free Zone.

9.-(1) The funds and resources of the Authority in relation to the operations of the Free Zone (hereinafter referred to as the funds of the Free Zone) shall comprise—

(a) moneys derived from rentals, leases, concessions or other activities carried on in the Free Zone;

(b) sums derived from loans raised by the Authority in accordance with the provisions of this Act;

(c) moneys earned by or arising from investments made by the Authority in connection with the operation of the Free Zone;

(d) such moneys as may from time to time be placed by Parliament at the disposal of the Authority for the purposes of this Act;

(e) such other moneys as may lawfully be paid to the Authority in respect of any matter incidental to its powers and duties under this Act.

(2) The funds of the Free Zone, save in so far as they may be invested or utilized pursuant to this Act, shall be held in any bank approved by the Authority.

Borrowing powers.

10.-For the purposes of enabling the Authority to carry out its functions under this Act, the Authority may, with the consent of the Minister responsible for finance, borrow money in such manner and subject to such conditions as that Minister may impose.

Power of Minister to guarantee loans to the Authority.

11—(1) The Minister responsible for finance, may, with the approval of the House of Representatives, guarantee, in such manner and on such terms and conditions as he thinks fit, the repayment of the principal and the payment of interest on any authorized borrowings of the Authority for the purposes of carrying out its functions under this Act.

(2) Where the Minister responsible for finance is satisfied that there has been default in the repayment of those principal moneys or in the payment of interest guaranteed under the provisions of this section, he shall direct the repayment or, as the case may be, the payment, out of the Consolidated Fund of the amount in respect of which there has been such default and any such repayment shall be a charge on the Consolidated Fund.

Repayment of and interest on, advances and sums issued to meet guarantee.

12—The Authority shall make to the Accountant General, at such times and in such manner as the Minister responsible for finance or other person designated by that Minister may direct, payments of such amount as may be so directed in or towards repayment of advances made to the Authority under subsection (1) of section 11 and of any sums issued in fulfilment of any guarantee given under that section, and payments of interest on any sum outstanding for the time being in respect of such advances and of any sums so issued, at such rate as that Minister may direct, and different rates of interest may be directed as respects different advances or sums and as respects interest for different periods.

Power to invest funds.

13—All funds of the Free Zone, not immediately required to be expended in the meeting of any obligations or the performance of any functions of the Authority under this Act, may be invested in such securities or other investments as may be approved by the Minister and the Authority may, with the approval of the Minister, sell all or any of such securities or other investments.

Accounts and audit.

14—(1) The Authority shall, as respects the funds of the Free Zone, keep proper accounts and other records in rela-

tion to its business and shall prepare annually a statement of accounts in a form which conforms with established accounting principles.

(2) The Authority shall also, from time to time, on the request in writing of the Minister, furnish information in respect of the accounts of the Authority or such other information as the Minister may require.

(3) The accounts required to be kept pursuant to subsection (1) shall be audited by an auditor or auditors appointed annually by the Authority and approved by the Minister.

(4) So soon as the said accounts have been audited, the Authority shall send the statement of its accounts referred to in subsection (1) to the Minister, together with a copy of any report made by the auditors on that statement or on the accounts.

(5) The auditors' fees and any expenses of the audit required under subsection (3) shall be paid by the Authority out of the funds of the Free Zone.

(6) The Auditor General shall be entitled, on the direction of the Minister responsible for finance, at all reasonable times to examine the accounts and other records of the Authority in relation to the operations of the Free Zone.

Annual report.

15—(1) The Authority shall, not later than five months after the end of each financial year relating to the operations of the Free Zone or within such further time as may in special circumstances be allowed by the Minister, cause to be made and transmitted to the Minister, a report dealing generally with the operations of the Free Zone during the preceding financial year.

(2) The Minister shall cause a copy of such annual report together with the annual statement of accounts and

the auditor's report thereon submitted to him pursuant to subsection (1) and subsection (4) of section 14 respectively, to be laid on the Table of the House of Representatives and the Senate.

Staff.

16—(1) The Authority may appoint and employ in relation to the Free Zone, at such remuneration and on such conditions as it thinks fit, such officers, agents and servants as it thinks necessary for the proper performance of its functions under this Act:

Provided that no salary exceeding fifteen thousand dollars per annum shall be assigned to any post without the prior approval of the Minister.

(2) The Authority may, with the approval of the Minister, make regulations determining generally the conditions of service of servants of the Authority and, in particular, but without prejudice to the generality of the foregoing power, may make regulations relating to—

(a) the grant of pensions, gratuities and other benefits to such servants and their dependents, and the grant of gratuities and other benefits to the dependents or estates of deceased servants of the Authority;

(b) the establishment and maintenance of sick funds, superannuation funds and provident funds, the contributions payable thereto and the benefits receivable therefrom.

(3) The Governor-General may, subject to such conditions as he may impose, approve of the appointment of any public officer in the service of the Government to any office with the Authority as relates to the Free Zone, and any public officer so appointed shall, in relation to pension, gratuity, or other allowance, and in relation to other rights as a public officer, be treated as continuing in the service of Government.

Power to delegate.

17—(1) The Authority may delegate to any of its members, or to any of its employees or agents, such of its functions under this Act as it may determine.

(2) Every delegation under this section shall be revocable by the Authority and no delegation shall prevent the exercise by the Authority of any function delegated.

Protection of members.

18—(1) No member of the Authority shall be personally liable for any act or default of the Authority done or omitted to be done in good faith in the course of performing the functions of the Authority under this Act.

(2) Where any member of the Authority is exempt from liability by reason only of the provisions of this section, the Authority shall be liable to the extent that it would be if the member were a servant or agent of the Authority.

Regulations

Regulations.

19—(1) The Authority may, with the approval of the Minister, make regulations—

(a) specifying the returns and information to be submitted by approved enterprises, to the Authority;

(b) prescribing and regulating the conditions for use of the Free Zone and its facilities and services, including the charges to be made for the use of the Free Zone and its facilities and services;

(c) regulating, promoting or restricting the movement of persons, conveyances, vessels and goods into, in and out of the Free Zone;

(d) regulating vehicular traffic anywhere within the Free Zone and in particular imposing speed limits on vehicles therein;

(e) providing for security arrangements as respects the Free Zone;

(f) providing for the disposal of unclaimed property within the Free Zone;

(g) prescribing any other matter or thing, whether similar to the above or not, in respect of which it may be expedient to make regulations for the purpose of carrying this Act into effect.

(2) Notwithstanding the provisions of section 29 of the Interpretation Act, regulations made under this Act may prescribe greater penalties than those specified in the said section 29, so, however, that the maximum penalty that may be so prescribed shall be a fine of five thousand dollars or imprisonment for twelve months.

Operations within the Free Zone

Approval of enterprise to undertake approved activity.

20.—(1) Any enterprise which proposes to undertake an approved activity shall apply to the Authority in writing for permission to do so, and shall submit such documents and information in support of its application as the Authority may require.

(2) Subject to the provisions of this Act, the Authority may, by order published in the *Gazette*, grant, subject to such terms and conditions as it thinks fit, approval for an enterprise to undertake the approved activity specified in its application under subsection (1).

(3) In every order made under subsection (1), a date shall be declared to be the date on which the relevant approved enterprise is deemed to begin the said approved activity for the purposes of this Act.

(4) On the application of an approved enterprise, the Authority may, upon such conditions as it thinks fit, amend an order made under this section in respect of the date on which the relevant approved activity is deemed to begin, and thereupon, the provisions of this Act shall, subject to any conditions specified in relation to such amendment, have effect as if for the date on which the relevant approved activity was declared pursuant to subsection (2) to begin, there were substituted the aforesaid date as amended.

Companies to be incorporated or registered locally.

21—(1) The Authority shall not grant approval for any approved activity in the Free Zone to any person other than a company incorporated or registered in Jamaica in accordance with the provisions of the Companies Act and which has obtained all necessary approvals from the Bank of Jamaica pursuant to the Exchange Control Act.

(2) Any purchase, assignment or transfer of shares in any company undertaking an approved activity in the Free Zone shall require the approval of the Bank of Jamaica under the provisions of the Exchange Control Act.

Insurance business.

22—(1) The Authority shall not grant approval to any person to carry on insurance business in the Free Zone unless that person—

(a) is registered in Jamaica in accordance with the provisions of the Insurance Act and has obtained the approval of the Superintendent of Insurance to operate in the Free Zone; or

(b) if not so registered, has obtained the approval of the Superintendent of Insurance in respect of the proposed transaction,

and has obtained all necessary approvals from the Bank of Jamaica pursuant to the Exchange Control Act.

(2) Any insurance company, broker, agent, or sub-agent may, with the approval of the Authority and of the Superintendent of Insurance, establish a branch within the Free Zone for the conduct of insurance business therein, so, however, that any such approval shall be subject to such conditions as the Authority and the Superintendent may consider necessary.

(3) All insurance business carried on in the Free Zone shall be subject to the provisions of the enactments for the time being in force in Jamaica relating to insurance.

(4) Any person granted approval pursuant to this section shall—

(a) keep such records in such forms and containing such particulars; and

(b) make such reports at such times,

as may be required by the Superintendent of Insurance, and shall permit the Superintendent of Insurance or any person authorized by him at all reasonable times to inspect and examine such records and any documentation relevant thereto.

(5) Where a person conducting insurance business establishes a branch in the Free Zone pursuant to subsection (2), the Authority shall permit the Superintendent of Insurance or any person authorized by him to enter the Free Zone for the purpose of carrying out the inspection or examination of records mentioned in subsection (4).

Dealing with or disposal of goods in Free Zone.

23—(1) Subject to section 31 and to any absolute or specific prohibition imposed by any enactment which may for the time being be in force, the Authority and any approved enterprise shall be entitled to import into the Free Zone free of customs duty as defined in subsection (9)—

(a) any capital goods, consumer goods, raw materials, components or articles intended to be used for the purposes of, and in connection with, an approved activity; and

Third Schedule.

(b) any of the articles specified in the Third Schedule if the Authority or the approved enterprise, as the case may be, satisfies the Collector-General that such articles are imported for the construction, alteration, reconstruction, extension or repair of premises in the Free Zone or for the equipping thereof, and for the purposes of this paragraph, articles for equipping premises shall be deemed to include equipment for offices and other ancillary facilities necessary for the proper administration of the premises and for the health, safety, hygiene and welfare at the premises of persons employed therein.

(2) The Minister may, by order, amend or vary the Third Schedule.

(3) All goods brought into the Free Zone shall be consigned—

(a) to the Authority or to an approved enterprise and such goods may, with the approval of the Authority be transferred from one approved enterprise to another or from the Authority to any approved enterprise, or from an approved enterprise to the Authority; or

(b) without prejudice to the provisions of section 34, to a bank acting on behalf of any party to a transaction involving the Authority or an approved enterprise.

(4) The Authority may take such steps as it deems necessary to preserve goods within the Free Zone, whether by moving such goods from one place to another or by storing such goods, and where any expenses are incurred by the Authority in so doing, the owner or consignee of such goods shall reimburse the Authority for any expenses so incurred.

(5) Subject to the provisions of this Act and any regulations, goods brought into the Free Zone pursuant to this section may—

(a) unless otherwise directed by the Authority, be stored, sold, exhibited, broken up, packed, unpacked, repacked, assembled, distributed, sorted, graded, cleaned, marked, re-marked, loaded, unloaded, reloaded, divided, mixed, separated, or otherwise manipulated; or

(b) be worked, processed or re-processed or otherwise manipulated or manufactured; or

(c) subject to any enactment pertaining thereto, be destroyed; or

(d) subject to subsections (6) and (7), be removed from the Free Zone or sent into the customs territory, whether as originally packaged or otherwise.

(6) Where any goods which are dutiable on entry into the customs territory (whether in their original condition or after manufacture or as part of or an ingredient of any goods manufactured in the Free Zone) are sent from the Free Zone into the customs territory, such goods shall be subject to the provisions of the Customs Act and any regulations made thereunder, and if such goods are intended to be disposed of in the customs territory, they shall not be removed from the Free Zone until—

(a) the consent of the Minister responsible for industry has been obtained; and

(b) the Collector-General is satisfied that all import restrictions relevant thereto have been complied with and all duties payable in connection with the importation thereof into the customs territory have been paid or security given therefor to his satisfaction.

(7) Samples of goods may be displayed in the Free Zone but shall not be taken into the customs territory without payment of, or without an undertaking satisfactory to the Collector-General for the payment of, the relevant duty except in cases where the Collector-General is satisfied that such goods are of no commercial value.

(8) Where goods are brought from the customs territory into the Free Zone for the purposes of an approved activity, such goods shall be deemed to be exported for the purposes of duty drawback under the Customs Act.

(9) In this section and in sections 27 and 28 customs duty includes, where applicable, consumption duty, sales tax and any additional stamp duty related to customs warrants.

Persons not to enter Free Zone without permission.

24—(1) No person shall enter, remain in or reside in the Free Zone without the prior permission of the Authority.

(2) Any person who contravenes the provisions of subsection (1) shall be guilty of an offence and shall be liable on summary conviction thereof in a Resident Magistrate's Court to a fine not exceeding one thousand dollars, or to imprisonment for a term not exceeding six months.

Retail trade.

25—(1) No retail trade shall be conducted within the Free Zone without the prior approval in writing of the Collector-General and of the Authority and any approval so granted shall be subject to such terms and conditions as the Collector-General or the Authority, as the case may be, may impose.

(2) Any person who contravenes the provisions of subsection (1) or of any term or condition imposed pursuant to that subsection shall be guilty of an offence

Prohibition on consumption or use of dutiable goods in Free Zone. Fourth Schedule.

26—(1) No goods, of a type prescribed in the Fourth Schedule which would on entry into the customs territory be dutiable, shall be used or consumed in the Free Zone without the prior approval in writing of the Collector-General.

(2) Any person who contravenes the provisions of subsection (1) of this section shall be guilty of an offence.

(3) The Authority may, by order, amend, revoke or replace the Fourth Schedule

Special provisions relating to articles imported with customs duty concessions.

27—Every approved enterprise which imports into the Free Zone any article with any benefit in respect of customs duty under the provisions of this Act shall—

(a) keep such records in such forms and containing such particulars as may be required by the Collector-General of the articles so imported by him;

(b) cause such articles to be marked with such mark and in such manner as may be required by the Collector-General; and

(c) permit the Collector-General or any person authorized by him at all reasonable times to inspect the

records relating to those articles and to have access to any factory, warehouse, assembly plant or other premises under the control of the approved enterprise for the purpose of examining any such articles which the Collector-General believes to be therein and of satisfying himself of the accuracy of the particulars in relation to such articles contained in such records.

Restriction upon disposal of articles imported with customs duty concessions.

28—No article imported into the Free Zone by any approved enterprise with any benefit in respect of customs duty under the provisions of this Act shall be used for purposes other than those of the approved activity, sold, given away or otherwise disposed of by such enterprise except—

(a) in the case of an assignment of the approved enterprise, for the purposes of which such articles were imported into the Free Zone and to be used within the Free Zone, to the assignee of such enterprise with the approval of the Authority;

(b) where such article is to be disposed of in the customs territory, with the consent of the Minister responsible for industry and upon the approved enterprise paying to the Collector-General an amount equivalent to the amount of customs duty and other dues and charges which would have been payable to the Government upon the importation of such article but for the provisions of this Act;

(c) in such other circumstances and on such terms as that Minister and the Collector-General may from time to time approve.

Manufacture or manipulation in Free Zone.

29—(1) Where any process of manufacture or manipulation which takes place within the Free Zone involves the use of dutiable materials, whether local or imported, the manufacturer or manipulator, as the case may be, shall maintain in a form acceptable to the Collector-General

records of the quantities of the various materials used in the process and, when required to do so by the Collector-General, permit verification of the records.

(2) Where under the provisions of this Act—

(a) entry into the customs territory is permitted of any goods manufactured, assembled, mixed or otherwise manipulated in the Free Zone; and

(b) either the goods or the materials used in the manufacture or manipulation thereof are dutiable,

the manufacturer or manipulator of such goods shall—

(i) obtain the prior approval in writing of the Collector-General for such entry (which approval may be granted or withheld as the Collector-General thinks fit); and

(ii) if the Collector-General so requires, manufacture or manipulate the goods under the supervision of the Collector-General.

(3) Any manufacture or manipulation permitted under this section shall be subject to such terms and conditions as the Collector-General may impose and to such regulations as may be made pursuant to this Act.

(4) The Collector-General may give an allowance for recoverable or irrecoverable waste, except that where such recoverable waste is sent into customs territory, it shall be dutiable in its condition and quantity and at its weight at the time of entry.

30—Regulations under this Act may prescribe allowances or deductions which may, having regard to the extent to which Jamaican labour or materials contribute to the ultimate value of any goods, be made in assessing the customs duty on goods entered from the Free Zone into the customs territory.

Disposal of goods abandoned in Free Zone.

31—(1) Where it appears to the Authority that any goods or property have been abandoned in the Free Zone for a period exceeding six months, the Authority may dispose of

such goods or property whether by destruction, sale or otherwise and in the case of disposal by sale, shall apply the proceeds of such sale against any fees or other expenses incurred in connection with those goods or property or such disposal.

(2) Where any balance remains after the settling of the fees and expenses pursuant to subsection (1), that balance may, if claimed within three months of the date of the disposal, and if the Authority is satisfied that the claimant was the owner of the goods disposed of or entitled thereto, be paid to the claimant, but where there is no claimant for the proceeds of any such disposal by sale, such proceeds shall be paid into and become part of the funds of the Free Zone.

(3) Nothing in subsection (1) shall be construed as authorising the sale or the disposal of any goods for use in the customs territory other than in such circumstances and on such terms as the Minister responsible for industry and the Collector-General may from time to time approve.

Goods not to be taken into or stored in Free Zone

32—Notwithstanding any other provision contained in this Act the following goods shall not be taken into or stored in the Free Zone—

(a) firearms and ammunition (other than by members of the Jamaica Constabulary Force or the Jamaica Defence Force or by security guards employed to work in the Free Zone in the course of their duties, or by such other persons as may be authorized by the Authority);

(b) dangerous explosives;

(c) petroleum, inflammable materials, hazardous cargoes and oil fuels other than in such quantities and on such terms and conditions as may be prescribed or permitted by the Authority

Licences

Import and export licensing.

33—(1) Approved enterprises shall not be subject to import licensing or, where goods are being shipped other than to customs territory, to export licensing.

(2) Export of goods from the Free Zone to the customs territory shall, save as otherwise prescribed by or pursuant to this Act, be subject to the same customs and licensing requirements as apply to goods imported from other countries.

Banking and foreign currency activities

Banking activities.

34—(1) All banking activities carried on in the Free Zone shall be subject to the provisions of the enactments for the time being in force in Jamaica relating to banking and exchange control.

(2) Any bank registered under the Banking Act may, with the approval of the Authority and subject to subsection (1), establish a branch within the Free Zone, and may at such branch—

(a) conduct normal banking business permitted under the provisions of the Banking Act, except that it may not, without the approval of the Bank of Jamaica, lend or make advances to—

(i) any person designated non-resident for purposes of the Exchange Control Act; or

(ii) any approved enterprise operating within the Free Zone; and

(b) subject to the approval of the Bank of Jamaica, operate foreign currency accounts for approved enterprises operating within the Free Zone.

(3) Where an overseas bank establishes a branch within the Free Zone which is independent of any other activity carried on in Jamaica by that bank, that branch—

(a) may be permitted to engage in foreign currency transactions whereby it can receive and make pay-

ments in foreign currencies without reference to the Bank of Jamaica; but

(b) shall not be accorded "authorized dealer" status pursuant to the Exchange Control Act, and consequently, shall not purchase or sell foreign currency in exchange for Jamaican currency.

Restrictions on borrowing and payment of employees.

35—(1) Any approved enterprise operating in the Free Zone—

(a) may move funds related to that enterprise into and out of the Free Zone without having to obtain permission from the Bank of Jamaica so to do; but

(b) shall not, without the approval of the Bank of Jamaica, be permitted to borrow funds for use in that approved enterprise from commercial banks, approved lending institutions or other sources situated in the customs territory.

(2) Where any approved enterprise is established within the Free Zone and employs persons on its staff who are designated non-resident for purposes of the Exchange Control Act, that enterprise may pay the emoluments of such staff in foreign currency and any staff so paid may operate an external account with any commercial bank whether within or outside of the Free Zone.

(3) Where an approved enterprise is established within the Free Zone and employs persons on its staff who are designated resident for purposes of the Exchange Control Act, that enterprise shall pay the emoluments of such staff in Jamaican currency and for that purpose that approved enterprise may, with the approval of the Bank of Jamaica, operate an account in Jamaican currency funded from a foreign currency account operated by such enterprise within the Free Zone or in the customs territory or outside Jamaica.

Payment for goods and services.

36—(1) Where an approved enterprise operating in the Free Zone supplies goods and services to customers within the customs territory, that enterprise shall be entitled to

receive payment for such goods and services in foreign currency, so, however, that it shall be necessary for the customer concerned to obtain the relevant approval from the Bank of Jamaica under the Exchange Control Act.

(2) Where a person within the customs territory supplies goods and services to an approved enterprise established within the Free Zone, that person shall be entitled to receive payment for such goods or services in foreign currency, so, however, that it shall be necessary for that person forthwith to sell the foreign currency to an authorized dealer in exchange for Jamaican currency.

(3) Subject to subsection (2), where a person within the customs territory supplies insurance services within the Free Zone, that person may, with the aproval of the Bank of Jamaica and on such terms and conditions as the Bank may impose pursuant to the Exchange Control Act, operate an external account funded from any foreign currency received as payment for premiums.

37.—(1) Every approved enterprise established within the Free Zone may, with the approval of the Bank of Jamaica, operate a foreign currency account with any commercial bank within the Free Zone, or in the customs territory or outside Jamaica.

(2) Where any person designated resident for purposes of the Exchange Control Act has any interest in an approved enterprise operating within the Free Zone, payments of interest, dividends or profits shall be made to such resident in foreign currency, so, however, that such payments shall from time to time be repatriated to the customs territory in accordance with the requirements of the Bank of Jamaica under the Exchange Control Act.

38—Any approved enterprise engaged in manufacturing shall be granted total relief from income tax in respect of profits or gains earned from such manufacture.

39—Any approved enterprise not engaged in manufacturing but engaged in activities involving international trading in products (including products originating in countries belonging to the Caribbean Common Market) shall be granted total relief from income tax in respect of profits or gains earned from the activities aforesaid.

Income tax relief in relation to international trading activities.

Miscellaneous

40—Service charges and dividends payable to an approved enterprise by organizations operating in the customs territory shall be subject to the provisons of the Exchange Control Act and to withholding tax under the Income Tax Act.

Service charges and dividends subject to exchange control and withholding tax.

41—Every approved enterprise shall submit to the Authority at such intervals as may be prescribed, such statistical data and such information and returns as respects their sales and purchases and other operations as the Authority may require or as may be prescribed.

Approved enterprises to submit returns.

42—Notwithstanding the provisions of section 4 of the Income Tax Act, it shall be lawful for the Commissioner of Income Tax to certify in such form as may be prescribed, the benefits enjoyed by an approved enterprise under the provisions of this Act in order that such certificate may be produced by the approved enterprise to the fiscal authorities of any other country in which the approved enterprise may be liable to suffer taxation.

Commissioner of Income Tax may issue certificates regarding benefits.

43—(1) A person who is a foreign national or Commonwealth citizen employed by the Authority or by an approved enterprise established in the Free Zone shall not, by virtue only of such employment, be exempt from the provisions of the Foreign Nationals and Commonwealth Citizens (Employment) Act, but the Minister responsible for the operation of that Act shall, in considering applications by or on behalf of such a person, have regard to the need to facilitate the operations of the Free Zone

Work permits.

(2) Where a person referred to in subsection (1) is employed by an approved enterprise, he and that enterprise shall be exempt from such provisions of the Foreign Nationals and Commonwealth Citizens (Employment) Act as authorize or require the payment or imposition of fees in relation to the grant of a work permit to him.

Offences and Penalties

Penalty for offences not otherwise provided for.

44—Every omission or neglect to comply with, and every act done or attempted to be done contrary to the provisions of this Act or any regulation, made thereunder, shall be an offence under this Act and in respect of such offence for which no penalty has been expressly provided, the offender shall be liable on summary conviction thereof in a Resident Magistrate's Court, to a fine not exceeding five thousand dollars, or, in default of payment, to imprisonment for a term not exceeding twelve months

Offences by bodies of persons and by servants and agents.

45—(1) Where an offence under this Act has been committed by a company, firm, society or other body of persons, any person who at the time of the commission of the offence was director, manager, secretary or other similar officer or a partner of the company, firm, society or other body of persons, or was purporting to act in such capacity, shall be deemed to be guilty of an offence, unless he proves that the offence was committed without his consent or connivance and that he exercised all such diligence to prevent the commission of the offence as he ought to have exercised, having regard to the nature of his functions in that capacity and to all the circumstances

(2) Where any person would be liable under this Act to any punishment, penalty or forfeiture for any act, omission, neglect or default, he shall be liable to the same punishment, penalty or forfeiture for every such act, omission, neglect or default of any clerk, servant or agent, or of the clerk or servant of such agent, if such act, omission, neglect or default was committed by such clerk or servant

in the course of his employment or by such agent when acting on behalf of such person or by the clerk or servant of such agent when acting in the course of his employment in such circumstances that had such act, omission, neglect or default been committed by the agent his principal would have been liable under this section.

Penalties.

46—(1) The provisions of subsection (1) of section 99 of the Income Tax Act shall apply to any false statement or representation made or any false return delivered or any false accounts kept or prepared with reference to any of the benefits created by this Act as if such false statement or representation had been made or such false return had been delivered or such false accounts had been kept or prepared with reference to income tax or profits or gains chargeable under the Income Tax Act.

(2) Every approved enterprise which contravenes the provisions of section 27 and every director, manager, agent and officer of that approved enterprise who is knowingly a party to the contravention, shall be guilty of an offence and on summary conviction thereof in a Resident Magistrate's Court, shall be liable to a fine not exceeding one thousand dollars, and in default of payment thereof, every such director, manager, agent or officer shall be liable to be imprisoned for a term not exceeding twelve months.

(3) Every approved enterprise which contravenes the provisions of section 28 and every director, manager, agent and officer of the approved enterprise who is knowingly a party to the contravention shall be liable to a penalty three times the value of the article in respect of which the contravention occurred and, in default of payment, every such director, manager, agent or officer shall be liable to be imprisoned for a term not exceeding twelve months.

FIRST SCHEDULE (Section 5(2))

Prescribed activities which may be carried on in Free Zone

(a) Warehousing and storing;

(b) manufacturing operations;

(c) trans-shipment operations;

(d) loading and unloading operations;

(e) exporting;

(f) importing;

(g) service operations, including banking, insurance, professional services;

(h) packing and shipping;

(i) assembling;

(j) processing, refining, purifying, mixing;

(k) merchandising.

SECOND SCHEDULE (Section 3)

Area of Free Zone

A

All that parcel of land situate in the parish of St. Andrew known as Lot 452 on the plan of Newport West, deposited in the Office of Titles on the 30th of August, 1967, and registered at Volume 1041 Folio 170 of the Register Book of Titles, excluding those areas shown as lots numbered 1 to 4, 11 to 16, 74 and Causeway Easement indicated as lot 452B as appear on the proposed sub-division plan of lot 452, deposited at the Survey Department and bounded on the North-eastern side by First Street, on the South-eastern side partly by Fourteenth Avenue and partly by lands registered at Volume 1048 Folio 182 of the Register Book of Titles, on the South-western side by Kingston Harbour now reclaimed lands and on the North-western side by Kingston Harbour now reclaimed lands.

B

Commencing at the common corner of lands in the parish of Kingston known as Newport East formerly Kingston Pen registered at Volume 942 Folio 27 of the Register Book of Titles and lands known also as Newport East formerly Kingston Pen registered at Volume 1048 Folio 262 of the Register Book of Titles and the southern boundary of Marcus Garvey Drive; thence North-westerly along the common boundary between Marcus Garvey Drive and lands registered at Volume 1048 Folio 262 of the Register Book of Titles to a point approximately 227 feet from the starting point; thence South-westerly, North-westerly and westerly along the boundaries common to Sections 1B 1C as appears on plan bearing Survey Department's Examination Number 138494 to a point on the high water mark of Kingston Harbour; thence South-easterly along the said high water mark to the common corner of lands registered at Volume

942 Folio 27 and lands registered at Volume 1048 Folio 262; thence North-easterly along the common boundary between the last two mentioned registered lands back to the starting point. Or as may be more particularly described as Section 1C and Section 1D on plan bearing Survey Department's Examination Number 138494

THIRD SCHEDULE (Section 23)

Building materials
Tools
Plant
Machinery
Pipes
Pumps
Conveyor belts
Other appliances and materials necessary for construction, alteration, extension and repair of premises.

FOURTH SCHEDULE (Section 26)

Food
Beverages
Cigarettes
Tobacco
Petroleum products.

PRINTED BY THE GOVERNMENT PRINTER DUKE STREET, KINGSTON, JAMAICA

DEFINING THE LEGAL STATUS OF EXPORT PROCESSING ZONES, 1989 (TOGO)

REPUBLIQUE TOGOLAISE
Union Peace Solidarity

Ministry of industry
and state enterprises

Ministry of economy
and finance

Ministry of planning and mine
and responsible for tranport and trade

LAW N° 89-14

Defining the legal status of Export Processing Zone (EPZ).

Centre Togolais de Promotion de la Zone Franche
de Transformation pour l'Exportation.
Immeuble B T C I 7e étage
169, Bd 13 janvier B P 3250
Tél : (228) 21 13 74 Fax (228) 21 52 31
Télex 5012 TG Lome TOGO

NATIONAL ASSEMBLY

LAW N° 89 - 14

Defining the legal status of the Export Processing Zones (EPZ)

Upon deliberation and adoption by the National Assembly ;

The President of the Republic hereby promulgates this law the provisions of which are set forth hereunder :

PREAMBLE

This law aims at promoting the expansion of export - oriented industrial activity in Togo by guaranteeing companies operating under this system the most conducive conditions for their competitiveness.

The law is an instrument for the promotion of economic development in as much as it enhances investment in the industrial sector, provides opportunities for the creation of permanent jobs locally, and makes it possible for the country's industrial sector to acquire new forms of technology and technical skills as well as to boost exports.

1. GENERAL PROVISIONS

Article 1 : This law shall establish, within the national territory, Export Processing Zones developed and managed by private, public or para-statal entities.

Article 2 : The objective assigned to the Export Processing Zone shall be to provide a favorable investment climate for export - oriented industries and services by encouraging the use of local manpower resources.

Article 3 : Export Processing Zone status may be granted to physically identified, fenced and isolated zones.

Article 4 : Export Processing Zone status may also be granted on an individual basis to any export-oriented company duly registered in Togo, irrespective of its location in the country.

Article 5 : Export Processing Zones shall be established by decree passed at a Cabinet meeting following a joint proposal by the Ministers of Industry Planning and Finance.

Article 6 : Government owned land may be leased out by the "Societe d'Administration des Zones Franches de Transformation pour l'exposition, described in Article 7 hereunder, with conditions to be defined by a joint decision of the Ministers of Industry and Finance.

2. - ADMINISTRATION OF EXPORT PROCESSING ZONES

Article 7 : The Administration of the Export Processing Zones shall be entrusted to a joint state and private company called "Societe d'Administration des Zones Franches" placed under the authority of the Minister of Industry. The Board of Directors of this company shall be composed of nine members, three of whom shall represent the state and six the private sector. Decisions of the Board of Directors shall be reached by simple majority.

This company shall be responsible for :

- idendifying and mapping the zones ;

- seeking developers for the zones ;

- building the basic infrastructure to the perimeter of the zones ;

- performing administrative formalities for the developers of the zones and zone companies ;

- coordinating the various zones ;

- examining and processing applications.

The company is not empowered to create or manage a Free Zone.

Article 8 : The public services necessary for the functioning of Export Processing Zones, especially the Customs Department and the Police Service, shall have permanent offices in the zone. Personnel assigned to these offices shall be placed under the authority of their respective administration :

Article 9 : Companies which have been granted Export Processing Zone status but which are not physically established in a zone per se must similarly accommodate the Togolese Customs Department.

3. - FRAMEWORK FOR EXPORT - ORIENTED COMPANIES

CHAPTER I : CONDITIONS OF ELIGIBILITY

Article 10 : Companies falling into one or more of the following categories may be authorized to establish within the Export Processing Zone or enjoy

Export Processing Zone status :

- labor - intensive companies ;
- advanced technology companies ;
- companies with local raw material base ;
- export - oriented companies engaged in international sub-contracting ;
- companies producing inputs for the above-mentioned entites
- service companies such as insurance companies, banks, industrial hard ware maintenance companies, support service companies, shipping comp. nies, or any companiee whose activities complement and facilitate those (export - oriented companies.

Export Processing Zone developers, private, public or para-statal entitie individuals and companies responsible for attracting companies into the zon which they created and provided with they necessary infrastructure, shall als enjoy Export Processing Zone status.

International trading companies, brokerage companies, and companie engaged in warehousing, packing, and reconditioning of goods shall b precluded from enjoying the benefits provided for under this scheme.

However, companies for which warehousing is an integral part of the industrial activities shall enjoy all the benefits of this law.

Article 11 : In order to be eligible for the benefits of an Export Processin Zone or to establish an Export Processing Zone, companies must fulfill th following conditions :

- guarantee to export all of their production subject to the provisions of art cle 28 ;
- reserve permanent jobs for Togolese nationals on a priority basis.

Article 12 : Wthin the framework of the development of the zones, foreig companies providing complementary services to the developers of the zon shall be entitled to all the benefits granted to the developers. However, servic companies may establish themselves in Togo only after obtaining a servic contract signed by Government approved developers.

Article 13 : An industrial company initially established in Togolese custom territory may submit a request to be granted Export Processing Zone status i during the previous three years, 75 % of its sales were exports.

CHAPTER 2. COMPANIES' OBLIGATIONS

Article 14: Companies which apply for the benefits provided for under this law must be incorporated or registered in the Togolese Republic and operate an accounting system which will enable them to comply with legal provisions and regulations as well as the existing business practices.

All these formalities must be accomplished before the authorization is confirmed.

Article 15: The "Société d'Administration des Zones Franches" shall collect from each company in the Free Zone an annual fee to be paid into a fund for the enhancement of the efficiency of public services and financing of vocational training.

Firms which have been granted individual Export Processing Zone status shall be subject to the same fee.

A decree shall establish the modalities for the enforcement of these provisions, by category of company.

CHAPTER 3 : PROCEDURE FOR GRANTING APPROVAL

Article 16 : In order to obtain authorization to operate under the Export Processing Zone system, a firm shall submit an application on a form issued by the Société d'Administration des Zones franches.

Article 17 : The completed application form shall be examined by a Standing Committee for the Approval of Export Oriented Companies. This Standing Committee shall be composed of 5 members of the Board of Directors of the Société d'Administration including the 3 Directors representing the State.

The chief executive of the Société d'Administration shall be the Secretary of the Standing Committee.

Article 18 : An Export Company Certificate shall be issued to companies selected to receive Export Processing Zone status by decision of the Minister of Industry upon proposal by the Societe d'Administration within a period of 2 business days from the date of application. However, a 30 - day period will enable the competent authorities to check on the background of the applicant and the company, after which approval shall be confirmed or withdrawn, by decision of the Minister of Industry.

CHAPTER 4 - NATURE OF BENEFITS

Article 19 : Companies which have been granted Export Processing Zon status shall enjoy the following customs benefits :

* exemption from import duty, general business tax and statistics tax o plant and equipment, including office furniture, spare sparts, raw material semi-finished products and consumable products necessary fo the installatio and operation of the company.

* 50 % reduction of the above duties and taxes on commercial vehicles ;

* exemption from all duties and taxes at the time of exportation of good initially imported into or manufactured within the Industrial Free Zone.

Article 20 : Companies granted Export Processing Zone status shall enjo the following tax benefits :

* 0 % company income tax rate for the first 10 years and 15 % rate from th 11th year following the date of approval of the company ;

* reduced rate of 2 % on salaries during the company's entire life span ;

* dividend tax exemption during the first ten years for non- national shar holders ;

* General Business Tax (TGA) exemption on work executed and servic rendered for the company enjoying Export Processing Zone status :

Article 21 : Companies established in the Export Processing Zone or enj ying Export Processing Zone status :

- shall be exempted from all duties, levies and taxes which are not expressl mentioned in Articles 19 and 20 above ;

- shall be free to determine prices, profit margins and rents of transactior between companies in the Export Processing Zone or between Zone compani and foreign markets ;

- may procure goods and secure services from the firm or company of the choice ;
- shall enjoy a preferential rate on port services ;

- shall be free to employ and dismiss Togolese or expatriate personn subject to the provisions of Article 11 ;

- may acquire their own telecommunications network such as satellite earth stations and microwave systems ;

- shall enjoy preferential rates from the Post and Telecommucations corporation of Togo (OPTT) ;

- shall be free to produce power for their exclusive consumption and pay preferential rates for power provided by the public utilities.

Article 22 : Under this law, authorization shall be given :

* to companies in the Export Processing Zone to transfer capital to countries outside the Franc Zone in order to undertake their investment and commercial transactions ;

* to their expatriate employees, shareholders and non-national creditors to transfer funds to countries outside the Franc Zone ;

* to companies for the right to have foreign currency accounts.

Article 23 : Companies exporting goods and or services shall, on confirmation of the approval by the Ministry of Industry be granted all the benefits set forth in this law and shall be exempted from obtaining any other authorization and license regardless of the nationality of the firm or the nationalities of owners.

4. - COMMERCIAL REGIME

Aticle 24 : Import and export transactions shall be made under the supervision of the Customs Department. Goods meant for the companies in an Export Processing Zone shall be directly and immediately conveyed to the appropriate zone to be cleared at a single customs post.

Article 25 : All types of goods may be allowed into the zone subject to any justifiable prohibition, especially on the grounds of public morality, public order and security as well as the protection of the health and life of persons and animals or the conservation of the ecosystem.

The list of goods and products which shall be prohibited from entering or being manufactured in Togo and within the Zone shall be drawn up by decree in conformity with the provisions of the Togolese Environmental Code.

Article 26 : Companies which have been granted Export Processing Zone status may be authorized on exceptional cases to sell a maximum of 20 % of production on the Togolese Customs territory by a joint decree of the Ministers of Finance, Industry, and Commerce.

In these cases Customs duties and taxes shall be payable on the finished product offered for sale within the national Customs territory according to the existing Customs tariff.

Article 27 : Sales made to companies enjoying Export Processing Zone status by companies established within the Customs territory shall be considered as exports under Customs regulations.

5. - PROVISIONS GOVERNING ACCESS TO THE EXPORT PROCESSING ZONE

Article 28 : Police duties and the maintenance of order shall be carried out by personnel of the Togolese Police Service according to the rules and regulations in force and by the zone's own security personnel.

Article 29 : No person shall be authorized to reside in an Export Processing Zone.

No commercial activity shall be authorized in an Export Processing Zone other than to serve the needs of companies and employees located in the Zone. Only service companies approved under the provisions of Article 10 may undertake activities in the zone.

Article 30 : Access to the Export Processing Zone shall be restricted to duly authorized persons and vehicles.

6. - FINAL PROVISIONS

Article 31 : Without prejudice to the specific provisions of the Togolese Environmental Code, any induvidual or company offending the provisions of Aricles 25 and 29 paragraph 2 hereunder shall be liable to a jail term of 2 to 12 months and a fine of F CFA 100,000 to 2 million, or only one of these two penalties.

Any individual or firm contravening the provisions of Article 29 paragraph 1 and Article 30 hereunder shall be liable to the penalties provided for under Article 34 of the Togolese Penal Code.

Any individual or company which in an application, declaration or document submitted in order to benefit from the provisions of this law makes a false declaration shall be liable to a jail term of two months to twelve months and a fine of F CFA 100,000 to 2 million or only one of these two penalties.

Any individual or company which shall deliberately use or attempt to use a false or misleading document or account shall be liable to the same penalties set forth in the preceding parapraph.

Any company which infringes the provisions of Articles 11, 14, 18 and 26 of this law shall be issued whith a warning by the Societe d'Administradtion des Zones Franches to be eventually followed by the withdrawal of the certificate and closure of the company.

Article 32 : Any commercial dispute which might arise among investors or between investors and developers or between devolopers and the Société d'Administration des Zones Franches in respect to the rights and obligations of the various parties shall be settled amicably. Failing this, the dispute shall be referred to the court of arbitration of the Chamber of Commerce, Agriculture and Industry of Togo. In case of disagreement, the conflict shall be referred to the International Center for the settlement of Investment Disputes on the Paris Chamber of Commerce for final settlement.

Article 33 : Texts setting forth the measures for the enforcement of this law shall be prepared, giving detailed information on the provisions of the law.

Article 34 : This law shall be published in the Official Gazette of the Togolese Republic and enforced as State Law.

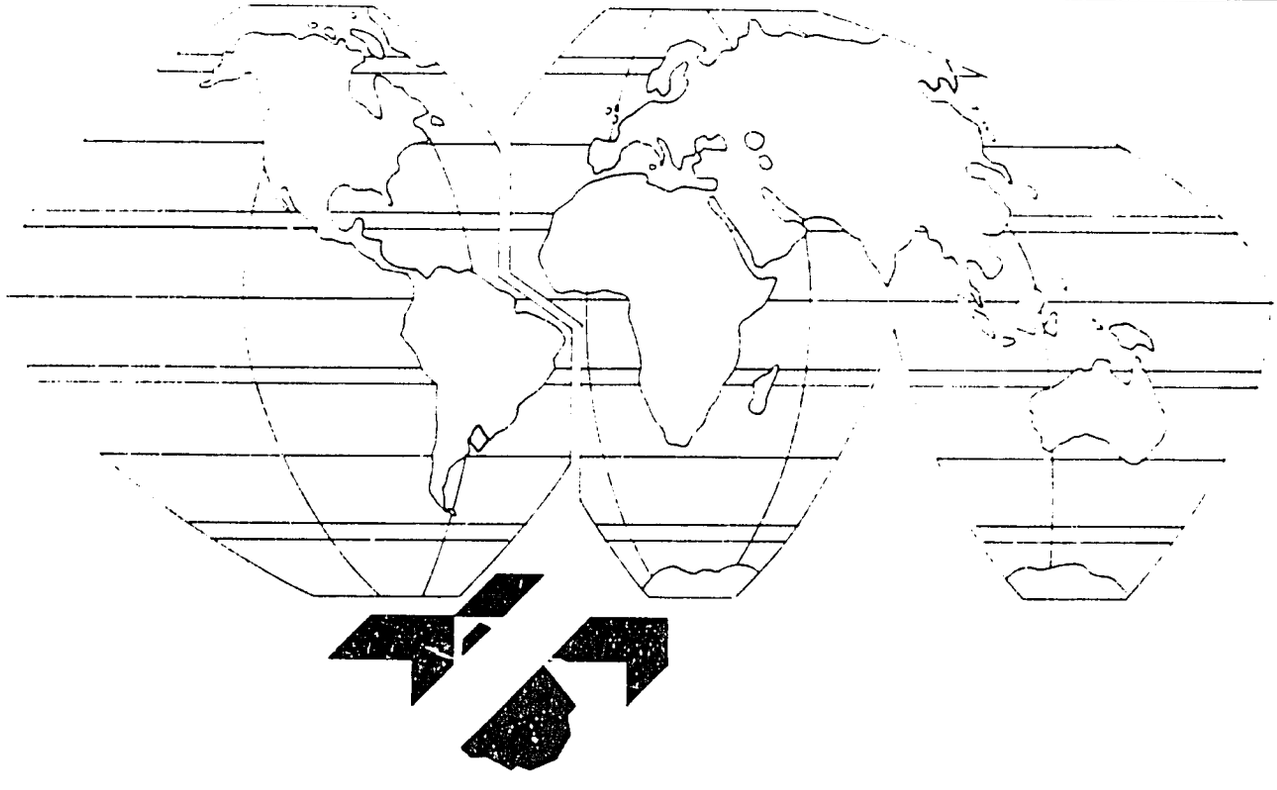
Done in Lome, on this 16th Day of September 1989

General GNASSINGBE EYADEMA

FREE ZONES LAW AND IMPLEMENTING REGULATIONS, 1987 & 1988 (URUGUAY)

URUGUAY

a new gate to the world



FREE ZONES LAW

SECTION I

GENERAL

SECTION 1 — The promotion and development of Free Zones is hereby declared of national interest, with a view to encouraging investment, expanding exports, increasing the use of domestic labor and fostering international economic integration.

SECTION 2 — Free Zones are public or private areas of the national territory, duly fenced in and isolated, to be determined by the Executive Power upon the advice of the Free Zones Advisory Committee, for the purpose of carrying out therein, under the tax exemptions and further benefits set forth by this law, any kind of industrial and commercial activities and render any services, inter alia:

a) to trade, store, warehouse, prepare, select, sort, break down, assemble, disassemble, handle or mix any foreign or domestic goods or raw materials;
b) to establish and operate any manufacturing industries;
c) to render any financial, data processing, repair and maintenance, professional and any other services required for a better performance of the activities to be carried out therein, and sell the above services to third parties;
d) to carry out any other activities which the Exectuve Power might deem convenient for the development of the domestic economy or for the economic and social integration of the countries involved.

The Executive Power shall adopt any measures required for such activities not to impair the exporting capacity of the industries already established outside the Free Zones.

SECTION 3 -- The expropriation of any private real estate required for the establishment of Free Zones and any access road thereto is hereby declared of public necessity.
The Executive Power is hereby authorized to exchange government-owned real estate for municipal of other public agencies-owned real estate, as deemed appropriate for the establishment of Free Zones and any access road thereto, or for the expansion of the existing Zones.

SECTION 4 — Only the personnel engaged in patrolling tasks and in rendering the services required for the activities carried out at the Free Zones, as well as any officials determined by the Executive Power, shall be entitled to live thereat.

SECTION II

FREE ZONES MANAGEMENT, CONTROL AND DEVELOPMENT

SECTION 5 — The Ministry of Economy and Finance, acting through the **Dirección de Zonas Francas** (Free Zones Office) shall be in charge of the management, supervision and control of the Free Zones. Said Office shall be granted the appropiate autonomy for the best fulfillment of its duties.

SECTION 6 — A Free Zones Honorary Advisory Committee is hereby established, which committee shall be composed of five members appointed as follows:

a) one appointed by the Executive Power to act as Chairman;
b) the remaining four elected by the members of the Board of Directors of the National Development Corporation representing the State who. Shall meet to these effects and adopt resolutions by a minimum of four affirmative votes. An equal number of substitute members shall be appointed through the same procedure.

SECTION 7 — The Honorary Advisory Committee shall be called by its Chairman or by the Minister of Economy and Finance, and it shall exclusively give advice on the selection of the areas of the national territory where privatly or publicly operated Free Zones will be established. The initiative shall exclusively correspond to the Executive Power, to which all applications shall be submitted and which shall in turn submit to the aforementioned Committee all applications deemed convenient.

Said Committee shall give its duly grounded opinion within a peremptory 30-running day term as from the date on which the above application is submitted by the Executive Power. The well-founded opinion of the Free Zones Office shall be enclosed to such application.

The Committee's opinion shall be approved by at least four affirmative votes. Otherwise, or in case such opinion be contrary to the Executive Power's advice, the file shall be submitted to the **Asamblea General** (Legislature) or to its Permanent Committee, whichever the case, which shall resolve within a 30-day term. Should no decision be adopted before the expiration of said term, the Executive Power shall be entitled to authorize the application submitted.

SECTION 8 — Each area defined as a Free Zone shall be operated by the State or by duly authorized individuals (hereinafter the "Operator" or "Free Zone Operator").

To these effects, operation means the activity whereby, in exchange for a price agreed upon with each user, an individual or legal person supplies the necessary and adequate infrastructure for the establishment and operation of a Free Zone.

SECTION 9 — The tax exemptions and benefits granted to users hereunder shall not apply to private companies authorized to operate a Free Zone, without prejudice to their obtaining —if that be the case— the declaration referred to by Decree-Law Nr. 14,178 dated March 28, 1974 (Industrial Promotion).

SECTION 10 — Any application for an authorization to operate a Free Zone filed by individuals or private companies shall be submitted to the Executive Power, enclosing an investment project whose economic feasibility shall be duly envidenced together with the benefits such project would bring to the country.
To obtain said authorization, the interested party shall pay the State either a single amount or periodic sums as agreed upon, without prejudice to the provisions of article 30 hereof.

SECTION 11 — The enterprises referred to in section 9 shall operate the Zone in compliance with the terms of the corresponding authorization. In case of any breach thereof, they shall incur a fine to be fixed according to the importance of the infringement, amounting up to N$ 50,000,000 (fifty million new Uruguayan pesos) adjusted according to the Consumer Price Index fixed by the **Dirección General de Estadística y Censos** (Statistics and Census Office), without prejudice to the revocation of the authorization on account of the nature of the infringement.

SECTION 12 — In case of revocation of the authorization or any other serious situation liable to cause said revocation, the Executive Power may, through the Free Zones Office, take any measure deemed necessary for the supply and maintenance of the infrastructure required for the due operation of the Free Zone.
The resolutions adopted to this end shall have no suspensive effect.

SECTION 13 — The owner or owners of the plots where private Free Zones shall be established shall grant an easement for the purpose of locating the real estate involved to that effect. Said easement shall be granted by the owner or owners of said plots for the same term as set forth in the pertinent authorization for the operation of the Free Zone. The Director of the Free Zones Office shall appear on behalf of the State.
This easement shall be in force for the term agreed upon, even in case of revocation of the authorization granted.

SECTION III

FREE ZONES USERS

SECTION 14 — The users of the Free Zones are all individuals or legal persons having acquired the right to carry out therein any of the activities referred to in Article 2 above. The enterprises set up in the Free Zones may not perform any industrial and commercial activities, or render any services, outside the Zones.

SECTION 15 — Direct users are those having acquired their right to operate within a Free Zone under an agreement entered into with the Free Zone Operator, whether the State or a duly authorized individual. To these effects the State may, at any time, contract directly through the Free Zones Office, and the user shall give security thereon.
Indirect users are those having acquired their right to operate in a Free Zone under an agreement entered into with a direct user, whereby use will be made or advantage taken of said direct user's facilites.
Any agreements granting the capacity of user shall be registered with the Free Zones Office and shall, upon the recordation thereof, be enforceable against third parties.

SECTION 16 — Any agreements entered into between the Free Zones Operators and direct users, or between direct and indirect users, governing the use of Free Zones, shall be considered null and void without the prior approval of the Free Zones Office.

SECTION 17 — The founders of stock companies having as sole objective the performance of activities in the capacity of user of a Free Zone may directly record the corresponding articles of incorporation and bylaws in the **Registro Público y General de Comercio** (Public Trade Registry). An attestation issued by the **Inspección General de Hacienda** (Finance Supervising Office) certifying that at least 50% (fifty percent) of the capital stock has been subscribed by three or more individuals or legal persons, and that at least 60% (sixty percent) of the subscribed capital stock has been paid up cash or in property liable of monetary valuation shall be enclosed to the application filed before the Registry.

Upon the above registration and publication of an extract of the aforementioned instruments in the **Diario Oficial** (Official Gazette), the company shall be deemed lawfully incorporated and shall be entitled to file an application before the Director of the Public Trade Registry requesting its entry in the Trader's Register.

The **Banco de la República Oriental del Uruguay** (Uruguayan State Bank) shall release the sum placed on deposit once the registration of the bylaws with Public Trade Registry has been duly evidenced. The same steps shall be taken in case the resolution is adopted not to incorporate the company. The payment of an additional 20% (twenty percent) of the subscribed shares, set forth in paragraph 2 of article 405 of the Commercial Code, as worded in article 208 of Law Nr. 13,318 dated December 28, 1964, shall not apply to these corporations.

SECTION 18 — Users of the Free Zones shall engage, for the activities to be performed therein, a minimum 75% (seventy five percent) of domestic labor, including naturalized citizens, as a condition for keeping their status as users and enjoying all tax exemptions, franchises, benefits and rights granted hereunder.

Under extraordinary conditions, said percentage may be reduced upon authorization of the Executive Power, on account of special features of the activities to be performed and public interest reasons.

SECTION IV

EXEMPTIONS AND BENEFITS

SECTION 19 — Users of the Free Zones shall be excempted from any national taxes, either present or future, including those requiring by law a specific exemption, as regards any activities carried out therein.

SECTION 20 — Special contributions to the Social Security Administration and other contributions set forth by law in favor of social security non governmental public persons(*) shall not be included in the above exemptions.

Whenever foreign personnel working in a Free Zone shall waive in writing any applicable social security benefits, it shall be exempted from the payment of the corresponding contributions.

Likewise, dividends or profits credited or paid to individuals or legal persons domiciled abroad shall not be exempted from the Income Tax on Industrial and Commercial Activities, provided they are taxed in the country where the holder thereof is domiciled and provided, further, there is a tax credit in such country for taxes paid in Uruguay (paragraph d of article 2 of Section 4 of the 1987 Regulations) (**Texto Ordenado 1987**).

(*) Translator's Note. Public agencies governed by a special system (Caja de Profesionales Universitarios, Caja Notarial, Caja Bancaria, etc.).

SECTION 21 — Any goods, services, products and raw materials, whatever their origin, imported into the Free Zones, shall be exempted from all import taxes, duties or charges applicable at the time of importation, including those requiring by law a specific exemption, whatever the nature thereof.
Any goods, services, products and raw materials with origin at the Uruguayan territory imported into the Free Zones shall comply all provisions in force as regards exports.

SECTION 22 — Any goods, services, products and raw materials imported into the Free Zones as well as any products manufactured therein may exit the Zones at any time, free from any present or future taxes or any other duties, encumbrances and charges, including those requiring by law a specific exemption, whatever their nature.
Whenever any goods, services, products and raw materials kept at the Free Zones or manufactured therein are imported into the national territory, they shall be considered as imports to all effects thereof.

SECTION 23 — The **Administración Nacional de Puertos** (Uruguayan Port Administration) shall receive any amounts paid for the services actually rendered to the goods with origin at or destination to the Free Zones, but the tariff charged shall not exceed the direct cost of the service involved.
For the application of the Port Administration tariff, the entry or exit of any goods and their transportation to/from the Free Zones shall be considered as international transit, but entry or exit duties shall be charged only once.

SECTION 24 — Public agencies supplying inputs or services to Free Zones users shall be entitled to apply to said users promotional tariffs.
Any industrial or commercial governmental monopolies shall not be applicable to Free Zones.

SECTION 25 — The State guarantees the user, during the entire term of the pertinent agreement, all tax exemptions, benefits and rigths hereunder, and shall be liable for damages in case of any breach thereof.

SECTION V

BUILDINGS AND FACILITIES

SECTION 26 — Any construction works carried out by direct users shall be governed by the technical regulations and specifications set forth by the Free Zones Office.
Said constructions shall only be used for the performance of the users' activities.

SECTION 27 — Any amounts payable by the users in Uruguayan or foreign currency to the Free Zones Operator —whether the State or any duly authorized private company— may be adjusted in compliance with the provisions of the respective agreement. Said amounts shall be payable during the entire occupancy of the premises, notwithstanding the expiration of the term agreed upon or any extension thereof.

SECTION 28 — Should the user fail to make three consecutive payments in the case of monthly payments, or one payment in the case of longer periods, the Free Zone Operator —whether the State or any private company— shall be entitled to request the user to vacate the Zone, after having served three day's notice by certified telegram demanding payment thereof.
The delivery procedures provided for in articles 1309 and ff. of the Uruguayan Code of Civil Procedure shall be applicable, without prejudice to any penalties which might be imposed by the Free Zones Office.

SECTION 29 — The collection of any amounts due shall be made through an executory or accelerated procedure, after having demanded payment thereof by certified telegram. No exceptions can be filed other than those set forth in article 108 of Decree-Law Nr. 14,701 dated September 12, 1977, without prejudice to the penalties referred to in the preceding article.

SECTION 30 — The Free Zones Office may agree with the Zone user or users and private Operators on offsetting any amounts due against infrastructure works built and services rendered by the users and liable to contribute to the improvement and development of the Zone, but under no circumstances shall the user or private Operator request any compensation not having been agreed upon in writing.

SECTION 31 — Any moneys paid by the users to the Free Zones Office shall approval of the Free Zones Office and of any co-contractor in the case of the Zones as well as to development works and any improvements thereof.

ARTICLE 32 — Direct users shall, during the entire term of the agreement or any extension thereof, be entitled to assign it to third parties upon the approval of the Free Zones Office and of any co-contractor in the case of private operation. They shall only be entitled to dispose of the works and facilities built by or acquired from the assignee of the aforementioned agreement, other users or the State.

Said agreements shall be considered null and void without the prior approval of the Free Zones Office.

SECTION 33 — Upon the expiration of the term set forth in the agreement or any extension thereof, direct or indirect users shall vacate the Free Zone. Otherwise, the delivery procedure provided for in articles 1309 and ff. of the Code of Civil Procedure shall apply. The same procedure shall be applicable in case of eviction.

SECTION 34 — The users shall only be entitled to carry out any building and improvement works upon the written consent of the Free Zone Operator.

Any non authorized works shall remain to the benefit of the Operator, the user being entitled to no compensation or reimbursement whatsoever; however, the Operator shall have the option to compel the user to the withdrawal thereof, without prejudice to any applicable penalites. The provisions of Decree-Law Nr. 14,219 dated July 4, 1974, as well as any amendments thereof and related provisions shall not be applicable to Free Zones.

SECTION 35 — Should the parties fail to come to an agreement, any construction and improvement works carried out by the user with the authorization of the Free Zone Operator — whether the State or any individual or private firm— shall be paid by the latter at their value on the date the user vacates the premises.
The parties, including the State, may resolve that any disputes arising between them as regards any improvements made in the Zone shall be submitted to arbitration.

SECTION VI

GOODS HELD AT FREE ZONES

SECTION 36 — Any foreign-origin goods, products and raw materials with destination to the Free Zones shall be promptly forwarded thereto upon their arrival in Uruguay. They shall not be stored in any warehouses except for those located within the Customs premises, and not beyond the term fixed by the corresponding regulations for their importation into the respective Free Zone.

SECTION 37 — No retail trade shall be carried out within the Free Zones.
Free Zones users shall be entitled to issue any warrants and warehouse certificates for the goods, products and raw materials stored in the areas allocated to them.
Said certificates shall only be negotiable upon the approval thereof by the Free Zones Office.
The entry and exit into/from the Free Zones of any bonds, securities, moneys in domestic and foreign currency and precious metales, for any purpose whatsoever, shall be fully free, as well as their possession, marketing, circulation and conversion or transfer thereof.

SECTION 38 — The transportation into or out of the Free Zones of any securities, Uruguayan or foreign currency and precious metals shall be fully free, as well as the possession, marketing, circulation and conversion or transfer thereof.

SECTION 39 — The regulations established by the Executive Power shall include provisions concerning any goods, products and raw materials abandoned in the Free Zones by the users or by the owners or consignees thereof at

the users' premises. Abandonment shall be deemed to take place whenever a 6-month term has elasped since the maturity date of the preceding overdue payment.

The Executive Power is hereby entitled to sell said goods, products or raw materials, whether at public auction or directly upon the due appraisal thereof.

In case said goods, products or raw materials belong to a direct user, the proceeds of the sale shall be allocated in the first place to the settlement of the pending amounts payable to the State or private Operator; should they belong to an indirect user, to the payment of his obligations with the respective direct user under paragraph 2 of article 15 herein; and should they belong to third parties, to the settlement of any obligation incurred with the user under the respective storage or consignment agreements.

The surplus, if any, shall be placed in deposit with the **Banco de la República Oriental del Uruguay** to the order of the respective owners. Creditors, Whatever their nature, may enforce their rights on such deposit.

Should said goods, products or raw materials be exported to the home market, any taxes, duties and charges in force on that date shall be levied thereon. The taxable amount shall be the one resulting from the corresponding appraisal or public auction, as certified by the Executive Power.

SECTION 40 — Any present or future requirements concerning the compulsory share of Uruguayan components in manufactured products, as well as any other present or future provision conditioning incoming or outgoing goods to/from the Free Zones shall not be applicable to the activities to be carried out therein, with the exception of those regarding control.

SECTION 41 — The Ministry of Economy and Finance shall issue all certificates of origin in compliance with the terms and conditions set forth by the Executive Power, no distinction being made therein as regards the origin of the products manufactured outside the Free Zones.

Any preferential treatments granted to Uruguayan exports by other countries as regards certain products and for limited volumes and values, shall be mainly applied for the benefit of the industries exporting said products already set up outside the Free Zones. The Executive Power shall adopt any necessary measures to that effect.

SECTION VII

PENALTIES AND FINAL PROVISIONS

SECTION 42 — Any breach or infringement of the provisions of this Law, its regulations and contractual provisions shall be penalized by the Executive Power as follows:

a) with a fine of up to NS 50,000,000 (fifty million new Uruguayan pesos), to be adjusted according to the consumer price index fixed by the Uruguayan Statistics and Census Office;
b) with the prohibition for a certain period of making any movement of goods to/from the Free Zones and/or performing any activities in the capacity of user;
c) with the loss of all exemptions and any other benefits granted hereunder.

SECTION 43 — The Executive Power shall regulated this law and take any setps required for the simplification of all services and proceedings concerning goods exports and imports to/from the Free Zones, and shall adopt any measures which, in compliance with the benefits granted hereunder and the necessary control procedures, allow a greater efficiency and rapidity in the performance of said operations.

SECTION 44 — It is hereby declared that the provisions of this Law shall apply to the Free Zones of Colonia and Nueva Palmira, established by Law Nr. 7,593 dated June 20, 1923.

SECTION 45 — The provisions of this law shall apply to present users of Colonia and Nueva Palmira Free Zones.
Users simultaneously carrying out activities outside the Free Zones shall be granted a 180-dy term as from the effective date of this Law to comply with the provisions of article 14 herein.

SECTION 46 — The Executive Power shall adopt any necessary measures for the preservation of the environment.

SECTION 47 — The transportation into the Free Zones of arms, powder, ammunition or other military materials, as well as any other declared contrary to public interest by the Executive Power, is hereby prohibited.

SECTION 48 — Decree-Law Nr. 14,498 dated February 19, 1976, and Nr. 15,121 dated April 10, 1981, are hereby revoked, as well as any other provision contrary to this law.

SECTION 49 — Let this law be published, etc.

Meeting Room of the House of Representatives.
Montevideo, May 22, 1987

HECTOR S. CLAVIJO
Secretary

VICTOR CORTAZZO
Chairman

REGULATION OF LAW NR. 15,921

MINISTRY OF ECONOMY AND FINANCE
MINISTRY OF INDUSTRY AND ENERGY

Montevideo, July 8, 1988

WHEREAS Free Zones Law Nr. 15,921 dated December 17, 1987, has to be regulated by the Executive Power,

THE PRESIDENT OF THE REPUBLIC
DOES HEREBY RESOLVE:

FREE ZONES AND FREE ZONES MANAGEMENT

SECTION 1 — The Republic of Uruguay is interested in the promotion and development of Free Zones with a view to encouraging investment, expanding exports, increasing the use of domestic labor and fostering international economic integration under the provisions of Law Nr. 15,921 which is regulated herein.

SECTION 2 — Any areas designated as Free Zones shall be duly marked out and fenced, so as to ensure their isolation from the rest of the national territory. All access ways thereto shall be determined by the **Dirección de Zonas Francas** (hereinafter "Free Zones Office"), no goods or people being authorized to enter or leave the Free Zones by ways other than those expressly permitted by the above mentioned Office.

SECTION 3 — The management of the State Free Zones and the supervision and control of the remaining Free Zones in the country shall come under the jurisdiction of the Free Zones Office of the Ministry of Economy and Finance. To this effect, said Office shall:

a) comply with and enforce the pertinent laws and regulations;
b) coordinate the rendering of the various services involved in the fulfillment of its duties, to which effect it shall be entitled to be in direct contact with any other national or regional authorities.

c) take all action required for having all access ways and boundaries of the Free Zones watched and the internal order thereof preserved, to which effects it shall be entitled to carry out all inspections deemed convenient for the control of the users and of private Free Zones.
d) propose the Ministry of Economy and Finance the Operative Regulations for the various Free Zones and the tariff to be charged in the State Free Zones;
e) resolve the installation and upkeeping of the pshysical, operational and functional infrastructure required for the operation and development of the State Free Zones.
f) propose the Ministry of Economy and Finance the cases in which the users of the Free Zones should be requested guarantees securing the services to be paid by said users;
g) represent the State in any agreements to be entered with the users of the State Free Zones, upon authorization of the Ministry of Economy and Finance;
h) authorize any agreements subscribed between the operators of the Free Zones and the direct users thereof, or between direct and indirect users, as well as the assignment of such agreements, all of which in compliance with the provisions of this Regulation;
i) organize and keep the Register of Agreements subscribed by State or private Free Zones direct or indirect users;
j) authorize goods and people to enter or leave the Free Zones and resolve the documents required to those effects;
k) determine the documents regarding the inventory of goods and the reductions suffered under industrial processes, with a view to keeping the permanent record of stocks;
l) supervise the compliance by the users of all obligations under the pertinent laws, regulations and agreements, and take the necessary action in case of default;
m) report to the Ministry of Economy and Finance any infractions committed by private users and operators and enforce the applicable penalties in compliance with the legal provisions in force;
n) indicate the persons authorized to live in the Free Zones in accordance to the provisions of Section 4 of Law number 15,921;

o) adopt any other resolution and take any other action within the scope of its technical autonomy, with a view to fulfilling the duties assigned by Law Nr. 15,921 and the pertinent regulations.

SECTION 4 — All State agencies shall cooperate with the Free Zones Office so as to simplify any proceedings directly or indirectly related to the activities to be carried out within the Zones.

SECTION 5 — Without prejudice to the technical autonomy of the **Dirección Nacional de Aduanas** (Uruguayan Customs Office) in the fulfillment of its duties, customs officers performing their duties in Free Zones shall act in direct coordination with the Free Zones Office.

ACTIVITIES

SECTION 6 — Any industrial or commercial activities carried out or services rendered within the Free Zones in compliance with Section 2 of Law Nr. 15,921 shall be stipulated in the agreements granting the users the capacity as such.

SECTION 7 — Industries already established in non free areas of the country shall enjoy the benefits stated hereunder, so that exports from the Free Zones do not impair their exporting capacity:

1) They shall be given preference over users in the share of available quotas, granted to Uruguay by other countries due to preferential treatments (Section 42 of Law Nr. 15,921 and Section 12 of this Regulation).
2) They shall be given preference over users in the share of available quotas for exporting to countries with quantitative restrictions as regards volume or value.
3) They shall enjoy an exclusive right to have a share in reciprocal trade agreements transacted under the bargaining power of the State in their purchases.

To the effects of paragraphs 1) and 2) of this Section and of Section 12, established industries shall be those which, on the date of requesting the respective quotas, are qualified to export from non free areas of the national territory and prove a satisfactory production capacity according to the volume to be exported of the good for which the quota is requested.

SECTION 8 — Automotive industries established in the country outside the Free Zones shall not consider as exports included in reciprocal trade agreements or as domestic components the goods with origin at the Free Zones or industrialized therein.

SECTION 9 — Users established in the Free Zones shall not carry out any industrial or commercial activities or render any services outside said Zones. Moreover, they shall not be entitled to render from the Free Zones services to be used outside the Free Zones (paragraph c of Section 2 of Law Nr. 15,921).

SECTION 10 -- Users authorized to carry out financial intermediation activities in the Free Zones shall be entitled to perform therein any activities comprised in their line of business, provided said activities are directed to third countries or to the users of the Free Zones.

SECTION 11 — Unless otherwise provided for by Law Nr. 15,921 and the corresponding regulations, the establishment and performance of any activities within the Free Zones shall be ruled by the general and specific provisions that the pertinent laws and regulations respectively set forth for said activities.
In the cases said provisions require an operating authorization or meeting certain requirements to carry out the proposed activity, the establishment or operation of the enterprise within the Free Zone shall be authorized by contract only upon the production of satisfactory evidence on the compliance with such requirements.
All bodies having supervising authority, whatever the nature thereof, shall be entitled to exert their own powers with respect to the activities carried out in the Free Zones, under direct coordination with the Free Zones Office and in compliance with the applicable regulations.

SECTION 12 — Users of the Free Zones shall be entitled to export goods under the preferential conditions granted to the Republic of Uruguay by other countries, subject to quantitative restrictions, under the same system applicable to industries established outside the Free Zones, provided that the latter shall in all cases be given preference in the share of the respective available quotas. The certificates of origin shall be issued according to the general regulations applicable to such destinations.

In the remaining cases, the Ministry of Economy and Finance shall issue in the prescribed manner the certificates of origin requested by the users, in compliance with the regulations applicable to each destination.

PRIVATE OPERATION FREE ZONES

SECTION 13 — All applications for the operation of a Free Zone by private firms or individuals shall be submitted to the Ministry of Economy and Finance, together with an investment project proving the economic and financial feasibility thereof and the advantage that the country would gain from the implementation of said project.

SECTION 14 — The following aspects shall be expressly mentioned in the project:

a) legal nature of the proposed enterprise;
b) location of the area proposed for its establishment;
c) causes and consequences of its establishment;
d) possibilities of future expansion;
e) services to be rendered, amount of the investment, financing sources and estimated personnel required;
f) description of infrastructure works (roads, sewerage, power and communications networks, etc.);
g) estimated term required for the implementation of the project;
h) evaluation of the number of users and their qualifications;
i) term for which the authorization is requested;
j) mode of payment proposed in compliance with the provisions of Section 10 of Law Nr. 15,921.

The Ministry of Economy and Finance shall be entitled to request in each case any further information according to the circumstances.

SECTION 15 — Legal persons intending to operate a private Free Zone shall have a sole and exclusive object related to the proposed activity.

SECTION 16 — All applications filed shall be submitted to the Free Zones Office, the Ministry of Economy and Finance being further entitled to ask any advice and opinions deemed convenient.
The term granted to the Executive Power to consider the issue shall not exceed forty-five days from the application filing date, excluding the periods during which the corresponding file is under study by the interested party or under consideration by the Advisory Committee referred to in the following section.

HONORARY ADVISORY COMMITTEE

SECTION 17 — All applications for the establishment of State or private Free Zones deemed feasible by the Ministry of Economy and Finance, and thus liable to be authorized, shall be submitted to the Honorary Advisory Committee referred to in Section 6 of Law Nr. 15,921.

SECTION 18 — The well-founded opinion of the Free Zones Office shall be enclosed to said applications together with the background deemed necessary for the fulfillment of the duties assigned to the Honorary Advisory Committee under paragraph 1 of Section 7 of Law Nr. 15,921.
The Honorary Advisory Committee shall be entitled to regulate its internal operation.

SECTION 19 — The Executive Power shall grant the authorization for the establishment of new Free Zones when applicable, in compliance with the Law and with this Regulation, and shall be entitled to require any guarantees deemed convenient.

ANNUALMENT OF THE AUTHORIZATION AND OTHER SITUATIONS

SECTION 20 — Should the Free Zones Office observe the occurrence of irregular situations which affect or might affect the normal operation of a private Free Zone or the activities carried out therein, it shall be entitled to

take or request the Operator to take any action deemed necessary or appropriate to stop or remedy such situations.
Private Operators shall cooperate with the Free Zones Office for the due compliance with the pertinent regulations and the best operation of the Zone under their control.

SECTION 21 — Without prejudice to the provisions of the preceding section, in case of any infringement or violation of the applicable regulations or of the terms of the authorization by the private Operator, the Free Zones office shall inform the Ministry of Economy and Finance thereon, submitting the pertinent background. Should the necessary evidence arise from these proceedings —which shall be notified to the interested party—, the Ministry of Economy and Finance shall be entitled to levy a fine up to the maximum stipulated by law, which fine shall be fixed according to the nature and importance of the infraction. Without prejudice to the above, the Executive Power shall be entitled to resolve, according to the circumstances, the annulment of the authorization.

SECTION 22 — Should the operating authorization be annuled, the Executive Power shall be empowered to take, through the Free Zones Office, the necessary transitory action for the upkeeping of the infrastructure and the rendering of the services required for the correct and normal operation of the Free Zone. The appeal which might be filed against such resolution shall have no suspensive effect.
Any action taken in compliance with the preceding paragraph shall not imply, with respect to the Free Zones Office, any substitution or assignment of the agreements entered into between the users and the operator of the Zone.

USERS

SECTION 23 — The first step to be taken in order to be granted the capacity of direct user of a State Free Zone shall be the filing of an application before the Free Zones Office.

Said application shall be enclosed to the Investment Project and other requirement set forth by the Free Zones Office. The applicant shall proceed at the same time to the reservation of the intended area, for the amount and under the conditions determined by said Office. Such reservation shall be charged and if the application is rejected, the repayment of the corresponding amount shall be set forth in the same resolution. Should the application be accepted, it will be possible to apply said amount to the payment of the guaranty referred to in paragraph d) of Section 3 of this Regulation, if applicable.

SECTION 24 — In the case of users of private Free Zones and of indirect users whatever the nature of the Free Zone, a draft agreement shall be submitted for obtaining the prior authorization referred to in Section 16 of Law Nr. 15,921, the Free Zones Office being entitled to request any further information deemed necessary.
The same procedure shall be applied for authorizing the assignment of users agreements.

SECTION 25 — Stock companies referred to in Section 17 of Law Nr. 15,921 may file the application to be granted the capacity of user enclosing the certificate of the **Inspección General de Hacienda** (Finance Supervising Office) referred to in article 29 of this Regulation.

SECTION 26 — Once the application has been filed in compliance with the above provisions and the pertinent report has been drawn up by the Free Zones Office —which report shall refer to paragraph f) of Section 3 of this Regulation, if applicable— said application shall be submitted to the Ministry of Economy and Finance.
Should the user's application refer to intermediation activities between the supply and demand of securities, moneys or precious metals, the Ministry of Economy and Finance shall forward said application to the **Banco Central del Uruguay** (Central Bank of Uruguay) to the effects of the provisions of Decree-Law Nr. 15,322 dated September 17, 1982, and other related and supplementary provisions. Should the establishment of the enterprise be authorized, a sole resolution shall be issued by the Executive Power. The firm may be authorized to operate either in any Free Zone or in a particular Zone.

SECTION 27 — Legal persons setting up as users in State or private Free Zones shall perform within the Uruguayan territory any of the activities set forth in Section 2 of Law Nr. 15,921 exclusively limited to Free Zones.

SECTION 28 — Stock companies engaged in performing activities exclusively in the capacity as users of the Free Zones shall submit before the Finance Supervising Office reasonable evidence to prove the subscription of fifty per cent of the capital stock thereof by three or more individuals or legal persons and the payment of sixty per cent of the subscribed capital stock in cash or in goods liable of pecuniary valuation, by deposit placed with the **Banco de la República Oriental del Uruguay** (Uruguayan State Bank) in the name of the company in process of incorporation and under the heading of "Cuenta integración de capital" (Paid-up capital account).

SECTION 29 — The subscription and payment of capital stock shall be attested before the Finance Supervising Office by means of the documents said Office might deem necessary, the corresponding certificate being issued thereon.

SECTION 30 — Stock companies incorporated under Section 17 of Law Nr. 15,921 shall comply with the applicable provisions of Section 3 of Regulation Nr. 123/967 dated February 23, 1967, within a 150-day term following the date of registration of the company with the **Registro Público y General de Comercio** (Public Trade Register).

SECTION 31 — All agreements for the establishment of users shall be subscribed with autograph signatures certified by a Notary Public. Upon the execution or approval thereof, said agreements shall be recorded at the Free Zones Office, which Office shall issue to each user a certificate stating his capacity as such. The proceedings commenced by any such user shall not be completed unless this certificate is produced before the pertinent bodies.

SECTION 32 — Users shall draw up a list of foreign workers and employees under their orders and state whether they are interested or not in availing themselves of the benefits granted by the Uruguayan social security system.
This shall be implemented by means of an affidavit signed by each worker or employee.

SECTION 33 — Should any user intend to employ above twenty-five percent of foreign labor, he shall request so by writing to the Free Zones Office, stating the reasons for such request.
This Office shall submit a report thereon to the Ministry of Economy and Finance.

TAX EXEMPTIONS

SECTION 34 — The State, under liability for damages, guarantees the user during the term of the agreement the exemption from all national taxes, either present or future, including those requiring by law a specific exemption, as regards any activities carried out in the Free Zones in compliance with the provisons appearing hereinafter.

SECTION 35 — Users of the Free Zones shall be exempted from the Income Tax on Industrial and Commercial activities as regards the activities carried out therein.

SECTION 36 — Dividends or profit credited or paid by the users of the Free Zones to individuals or legal persons domiciled abroad shall not be exempted from the Income Tax on Commercial or Industrial activities provided they are taxed in the country where the holder thereof is domiciled and provided, further, there is a tax credit in such country for taxes paid in Uruguay.

SECTION 37 — Dividends or profit credited or paid by the users of the Free Zones to individuals or legal persons domiciled abroad shall be exempted from the Income Tax on Industrial and Commercial activities provided they are not taxed in the country where the holder thereof is domiciled or

provided they are taxed in the country where the holder thereof is domiciled and there in no tax credit in such country for taxes paid in Uruguay.
Taxpayers interested in enjoying the exemption set forth in the preceding paragraph shall produce a certificate issued by the competent State authority attesting that the above dividends or profit are taxed in the country where the holder thereof is domiciled and there is no tax credit for taxes paid in Uruguay, or that they are not taxed. Said certificate shall be duly translated and authenticated.

SECTION 38 — The income of insurance companies operating outside the Free Zones obtained from insurance contracts entered into by the users of the Free Zones and covering risks therein or on the way to or from the Free Zones, shall not be included for calculating the income tax to be paid by said companies.

SECTION 39 — Networth tax taxpayers users of Free Zones shall not include the capital allocated to the activity carried out in the Free Zones in the taxable amount or in the estimated value of the furniture and fixtures of their dwelling, if applicable.

SECTION 40 — Shareholders of stock companies and limited partnerships holders of nominative share capital, users of Free Zones, shall not include the corresponding share in the capital of said companies allocated to the activities carried out therein in the taxable amount or in the estimated value of the furniture and fixtures of their dwelling, if applicable.
The same shall apply to the members of partnerships users of Free Zones.

SECTION 41 — The incorporation of stock companies referred to in section 17 of Law Nr. 15,921 shall be exempted from the tax on the incorporation of stock companies. Likewise, said companies shall be exempted from the tax levied on capital stock increases.
Should the aforementioned companies lose their capacity as users and be interested in modifying their corporate object so as to operate outside the Free Zones, they shall follow all proceedings required for the amendment of their bylaws in compliance with the general provisions applicable to these companies, and pay the tax stipulated for the incorporation thereof.

SECTION 42 — Financial intermediation institutions authorized to operate in the Free Zones shall be exempted from the tax levied on Bank Assets.

SECTION 43 — The following shall be exempted from the Value-added Tax:
a) the circulation of goods and the rendering of services within the Free Zones;
b) the admission of goods into the Free Zones from abroad.

SECTION 44 — The transportation of goods from outside the Free Zones into the Free Zones and the rendering of services within or from non free areas to users of the Free Zones shall be considered as exports to the effects of the calculation of the Value-added Tax. The **Dirección General Impositiva** (General Tax Office) shall determine all requirements and proceedings deemed convenient for an efficient supervision thereof.

SECTION 45 — The final admission of goods from the Free Zones to the domestic market shall not be exempted from the Value-added Tax if applicable. In the case set forth in Section 39 of Law Nr. 15,921, the taxable amount shall be the one resulting from the corresponding appraisal or public auction, as certified by the Free Zones Office.

SECTION 46 — The following shall be exempted from the Specific Internal Tax:
a) the circulation of goods within the Free Zones;
b) the importation of goods into the Free Zones from abroad.

SECTION 47 — The General Tax Office shall set forth the proceedings for the repayment of the Specific Internal Tax included in the purchase of goods required for their activities which the users of the Free Zones make outside said Zones.

SECTION 48 — The admission of goods from the Free Zones to the domestic market shall be considered as imports to the effects of the Specific Internal Tax.
In the case set forth in Section 39 of Law Nr. 15,921, the taxable amount shall be the one resulting from the apparaisal or public auction, as certified by the Free Zones Office.

INCOMING AND OUTGOING GOODS

SECTION 49 — As regards the National Port Administration duties, goods imported or exported from/to other countries shall, to the effects of their transportation to/from the Free Zones, be considered as international transit, and the corresponding duties shall be charged upon the admission of the goods to the Free Zones.
Should said goods be carried from a Free Zone to a non free area of the Uruguayan territory, the National Port Administration shall recalculate the duties for the services rendered according to the tariff for import duties.

SECTION 50 — Any goods with origin at the domestic market required by industrial or commercial users to be consumed within the Free Zones, or to be used in construction works or in the repair of industrial equipments, facilities and buildings, may be admitted to the Free Zones upon the presentation of the documents required by the Free Zones Office.
Said Office shall be responsible for the supervision and control of the compliance with this provision.

SECTION 51 — The transportation of goods to/from the Free Zones shall be made by public or private transportation lines, having agents or representatives duly authorized by the Free Zones Office and registered with said Office.

SECTION 52 — The abandonment of goods in State or private Free Zones shall be deemed to take place:
a) when owners or consignees declare so by writing;
b) after six months from the maturity date of the last overdue payment.

SECTION 53 — The auction sale of the goods abandoned within the Free Zones shall be carried out by the **Dirección Nacional de Aduanas** (National Customs Office) in compliance with the provisions in force.

SECTION 54 — The National Customs Office shall appraise the goods to be sold directly or in public auction based on their customs current value plus import duties to be charged upon their admission to the home market.

BUILDINGS AND FACILITIES

SECTION 55 — Users undertaking to make building works in the plots assigned to them shall submit a draft plan for the approval and authorization of the Free Zones Office, without prejudice to meeting the requirements set forth by the remaining competent authorities.

SECTION 56 — The Free Zones Office shall authorize in each case and according to the type of enterprise the lines and features of the buildings to be constructed in the Free Zones.
The users shall carry out the approved project in compliance with the terms of the corresponding agreement.

SECTION 57 — Before starting their activities, the users shall request the Free Zones Office to inspect the machinery and equipments, safety and public health facilities as well as working conditions.
All buildings in the Free Zones shall be constructed with fire-resistant materials and shall be duly insured.

SECTION 58 — The Free Zones Office shall be entitled to determine or authorize special areas or facilities exclusively designed for exhibitions of goods, whether manufactured or nor by the users of the Free Zones, the use of said areas being subject to the payment of a sum fixed by the Free Zones Office.

INFRACTIONS AND PENALTIES

SECTION 59 — The Free Zones Office shall report the infractions by the users of Law Nr. 15,921, the pertinent regulations and contractual provisions, submitting the corresponding background to the Ministry of Economy and Finance.
Said Ministry shall determine the infractions committed as well as the applicable penalties according to the importance of the infraction and in compliance with the provisions of Section 42 of Law Nr. 15,921. The recurrence shall be an aggravating consideration.

The Free Zones Office shall be responsible for the enforcement of the corresponding penalties.

SECTION 60 -- Present users of the Free Zones being legal persons shall attest before the Free Zones Office, within a 120-day term as from the publication of this Regulation, that they are already engaged in the modification of their corporate object in compliance with the provisions of Section 27 hereof.

SECTION 61 — Regulations Nr. 734/976 dated November 3, 1976, 416/980 dated July 16, 1980, 65/983 dated March 3, 1983, 68/984 dated February 10, 1984, 566/985 dated October 18, 1985, and those dated December 3, 1986 and December 17, 1986, as well as any other regulations which might directly or indirectly be contrary to this Regulation,are hereby repealed.

SECTION 62 — Let this Regulation be published, etc.

Ricardo Zerbino, Secretary of Economy and Finance
Jorge Presno, Secretary of Industry and Energy
Julio Maria Sanguinetti, President of the Republic

SELECTED BIBLIOGRAPHY

SELECTED BIBLIOGRAPHY

Bhatia, R.K. "Export Processing Zones and Manufacture In Bond Programme." (n.d.)

Carr & Paynter, Inc. "A Medium Term Export Development Strategy for Kenya." Vols. 1-2. Prepared for The Ministry of Finance, Government of Kenya, April 1989.

Central Bank of Kenya and International Finance Corporation. "Report and Recommendations on the Development of the Money and Capital Markets in Kenya." October 1984.

J.E. Austin Associates. "Kenya Private Sector Description: Summary of Findings." Briefing Document, November 1989.

_____. "MAPS Phase III -- Private Sector Diagnosis: Kenya." Internal Draft Report, November 1989.

Jurong Environmental Engineering PTE Ltd. Singapore. "Export Processing Zone at Embakasi, Nairobi, Kenya." 1987.

Keesing, Donald B. "The Four Successful Exceptions." Washington, D.C.: World Bank, September 1988.

Keesing, Donald B. and Lall, Sanjaya. "Marketing Manufactured Exports from Developing Countries: Learning Sequences and Public Support." Paper prepared for the UNU/WIDER Conference on "New Trade Theories and Industrialization in Developing Countries", Helsinki, Finland, August 2-5, 1988.

Keesing, Donald B. and Singer, Andrew. "How to Provide Impact Assistance to Manufactured Exports from Developing Countries." October 16, 1989.

_____. "What Goes Wrong in Official Promotion and Marketing Assistance for Manufactured Exports from Developing Countries." October 16, 1989.

Kenya Ports Authority. Annual Bulletin of Port Statistics. 1985, 1986 and 1987.

_____. Annual Report and Accounts for the Period 1st July 1986 to 30th June 1987. 1987.

_____. KPA Development Plan: 1984-1988.

_____. Mombasa Port Cargo Throughput (DWT). 1987, 1988 and 1989.

_____. Six Months Report and Accounts for the Period 1st January to 30th June 1986. 1986.

_____. Tariff Book No. 1: Rates and Charges for Services to Ships -- Marine Services, Ships Dues, Stevedoring. July 1, 1988.

-155-

_____. Tariff Book No. 2: Rates and Charges for Services to Cargo -- Wharfage, Shore Handling, General Services. July 1, 1989.

Kenyan Association of Manufacturers. "Export Incentives for Kenyan Industry." Final Report presented by SRI International, Mwaniki Associates and The Services Group. July 1989.

_____. Price Controls -- Experiences and Opportunities in Kenya's Manufacturing. Nairobi: English Press, 1988.

Kim Duk Choong. "A Korean View of Development in Sub-Saharan Africa." Paper presented to an IFC/FIAS Conference on the Promotion of Foreign Investments in Sub-Saharan Africa, Washington, D.C. September 1989.

Management Systems International. "The Impact on the Poor of USAID's Private Sector Programs in the Dominican Republic." April 1989.

Marsden, Keith. "The Role of Foreign Direct Investment in the Private Investment Climate in Sub-Saharan Africa." (n.d.)

Marsden, Keith and Bélot, Thérese. "Private Enterprise in Africa -- Creating a Better Environment." World Bank Discussion Papers, No. 17. Washington, D.C.: World Bank, 1987.

Mbogua, J.P. Proposals for New Investment Strategies in Kenya with Emphasis on Industrial Development with Procedures. Washington: March 1983.

Mwencha, J.E.O. Prospects for the Emergence of Regional Multinational Enterprises in the PTA Subregion. Lusaka: PTA Secretariat. (n.d.)

Republic of Kenya. Sessional Paper No.1 of 1986 on Economic Management for Renewed Growth. Nairobi: Government Printer, 1986.

_____. Speech Delivered to the National Assembly on 16th June, 1988, by the Hon. Prof. G. Saitoti, Vice President and Minister for Finance, Republic of Kenya, When Presenting the Budget for the Fiscal Year 1988/89.

_____. Speech Delivered to the National Assembly on 15th June, 1989, by the Hon. Prof. G. Saitoti, Vice President and Minister for Finance, Republic of Kenya, When Presenting the Budget for the Fiscal Year 1989/90.

_____. "Manufacture-In-Bond-Programme." February 10, 1988.

_____. Ministry of Commerce, Department of External Trade. Kenyan Export Directory. 5th Edition, 1988-89.

_____. Ministry of Finance. "A Medium Term Export Development Strategy for Kenya." Vol. I. (n.d.)

_____. Ministry of Planning and National Development, Central Bureau of Statistics. Economic Survey. 1989.

_____. Statistical Abstract. 1986.

_____. Working Party on Government Expenditures. "Report and Recommendations of the Working Party Appointed by His Excellency the President." July 1982.

Rhee, Y.W. "Instruments for Export Policy and Administration: Lessons from the East Asian Experience." World Bank Staff Working Papers, No. 725. Washington, D.C.: World Bank, 1985.

Rodriguez, Arelis M. "Impact of the Free Zones on Female Employment and Entrepreneur Development in the Dominican Republic." Presented to the World Bank, Washington, D.C. August, 1989.

SRI International and Mwaniki Associates. "Prospects and Strategies for Investment Promotion in Kenya." Draft Report, January 1986.

PTA. Treaty for the Establishment of the Preferential Trade Area for Eastern and Southern African States. 1984.

UNCTAD/GATT (International Trade Centre). Duty Drawback on Exports. Geneva: UNCTAD, 1979.

USAID/Kenya. "Report and Recommendations for Assistance in Private Sector Export Promotion." January 1986.

World Bank. "Kenya: Industrial Sector Policies for Investment and Export Growth." Vols. 1-2. Washington, D.C.: World Bank, June 30, 1987.