Designing Economic Zones for Effective Investment Promotion

Working Group 1: Investment Policies and Promotion
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Towards a more Comprehensive and Generic Terminology

- Free trade zones (FTZs; also known as commercial free zones): are fenced-in, duty-free areas, offering warehousing, storage, and distribution facilities for trade, trans-shipment, and re-export operations.
- Export processing zones (EPZs): are industrial estates aimed primarily at attracting export-oriented investments. They cover usually a wide array of manufacturing industries.
- Special economic zones (SEZs): are larger estates and could be considered cities on their own. They usually cover all industrial and service sectors and target both foreign and domestic markets. They provide an array of incentives ranging from tax incentives to regulatory incentives. In addition, they permit on-site residence.
- Specialized zones/Investment Zones (SZs): targeted at specific sectors or economic activities. Examples of SZs include science/technology parks, petrochemical zones, logistics parks, airport-based zones, and so on. They may restrict the access of companies in non-priority sectors, and their infrastructure is mostly tailored according to their sectoral targets.

Towards a more Comprehensive and Generic Terminology

- Terminology is highly confusing and used interchangeably by governments.
- We need a terminology that is generic enough to allow us to describe all kinds of zones.
- Focus should be on the policy package & objectives rather than the terminology of zones.
- (Free Trade Zones, Export Processing Zones, Special Economic Zones, Specialized Zones)= **ECONOMIC ZONES.**

Economic Zones are ring-fenced enclaves that enjoy special regulatory, incentive and institutional frameworks that are different from the rest of the economy.

Readapting Economic Zones: A Contemporary Vision

The Governments 'needs:

- to continue attracting FDI and increasing exports
- to achieve sustainable inclusive green growth strategies that include but not limited to exports and investment creation;
- to generate employment opportunities as the financial crisis unfolds ;
- to create linkages with the local economy to improve socio-economic conditions and eliminate regional disparities.
- to generate tax revenues as their budget deficits increase

Call for a new vision for the design of Economic Zones

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Readapting Economic Zones: A Contemporary Vision

There has been a shift in how to design Economic Zones to achieve broader development objectives and effective investment promotion.

Features of New Economic Zones

Strategy

- Economic Zone strategy is strongly linked to national development, investment and industrial strategies.
- Different Economic Zones in one country are not fragmented development initiatives; they must complement each other.

Design & Management

- Move towards the development of SEZs and SZs (industry and services with high value added
- Independent regulatory bodies backed up by a Law
- Private sector development & management of zones
- PPPs for infrastructure provision/PPP financing
- Cluster zone modelling and supply chain management
- Fully integrated zones with on-site residence

Incentives

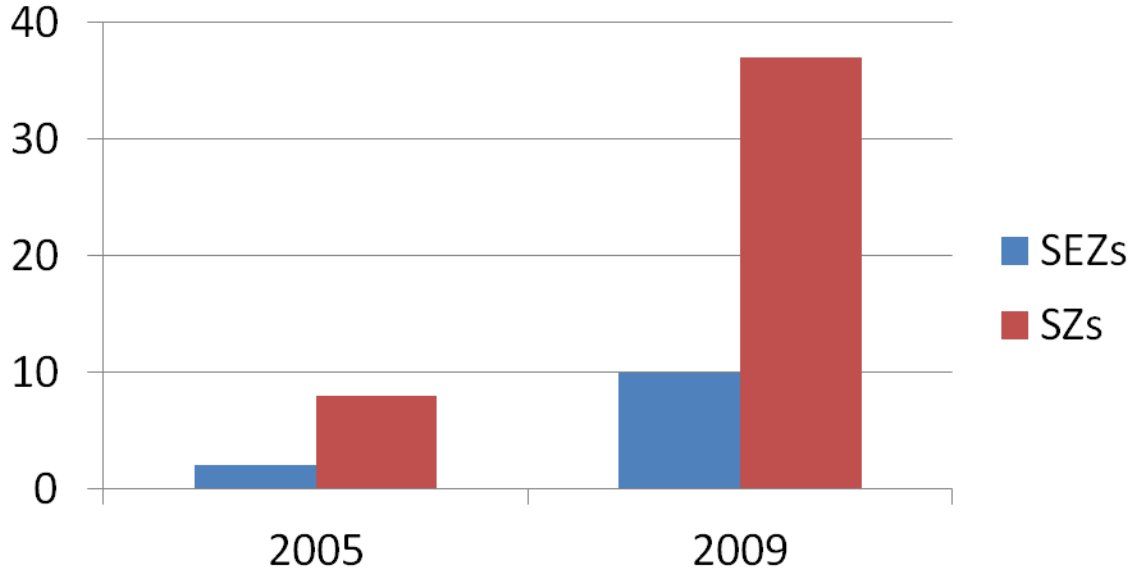
- Focus on regulatory and administrative incentives
- Fully inclusive Single window & one stop shop services.
- Innovative development policy incentives linked to R&D, skills development, SMEs & regional development.
- Less reliance on tax incentives and more focus on services (business development services)

New Trends in MENA: Following the Trend

Good examples are on the rise in MENA, governments have changed the way they design EZs to incorporate global changes in the field and better meet their own socio-economic objectives:

- The emerging trend in EZ development approach in MENA is a movement away from the classical development of “free trade zone” and “export processing zones” towards “special economic zones” and “specialized zones” focusing on high value added.

- The stock of SEZs and SZs in MENA has increased from 2 and 8 respectively in 2005 to 10 SEZs and 37 SZs in 2009.



New Trends in MENA: Following the Trend

- ✓ Private-sector role: More than 18% of MENA's EZs are now privately developed and managed.
- ✓ The use of administrative incentives: it has increased dramatically & OSS is widely used across the region.
- ✓ Business Services: The use of R&D and skills development services as incentives to attract investment has increased.
- ✓ Innovative incentives have been introduced rather than relying solely on classical customs incentives

New Trends in MENA: Following the Trend

Jordan's Development Zones: the move towards the integrated, multi-sectoral zones

Currently 3 in operation, more in the future

- strongly linked with National Development Strategy of Jordan
- Independent regulatory body: Development Zones Commission (DZC) creates, regulates and monitors DZs. DZC is a governmental entity financially and administratively. Law 2/2008 delegates full power to DZC to create efficient OSS, defines clear land ownership policies. independent.
- One stop shop facilities
- Private sector development and management of zones
- On-site residence
- Skills development centers

New Trends in MENA: Following the Trend

Abu Dhabi's Specialized Zones: the move towards high value added specialized industrial zones

- Vocational training centres ensuring supply of skilled labour force
- Workers' Residential Cities providing world standard labour accommodation.
- Streamlined labour procedures through the foreign labour services – FLS
- Value-Added Services, operational requirements and Business Matchmaking – BMM
- State of the art infrastructure
- Cluster based zoning model allowing the full integration within the industry value chain deriving synergy benefits
- Duty free import of machinery and raw materials
- Customer centric approach through the adoption of a "One stop shop" concept.
- Availability of energy at competitive rates

New Trends in MENA: Following the Trend

Egypt's Investment Zones: the move towards non-tax incentive based zones that compete based on their facilities and administrative facilitation

- Independent zone board backed up by a law
- One-stop shop services
- Private sector development and management of zones
- Encouraging the creation of specialized sector clusters (industry, services, agriculture, tourism, finance, entrepreneurship, renewable energy..etc.)
- Training centers are to be established by the investor with the help of the Ministry of Manpower and Industrial Training Center
- R& D center is to be established in every investment zone to support development of products & enhancement of industrial operations in the zone.

New Trends in MENA: Following the Trend

Saudi Arabia's New Economic Cities: a successful model

- Residents and workers will enjoy a virtually unique combination of high-quality housing, modern amenities, excellent sports and recreational facilities and world-class specialist healthcare. International schools will offer global curricula for workers' children from all over the world while luxurious malls will offer shops and restaurants featuring the finest goods and food from around the globe.
- Supportive regulatory environment will create significant competitive advantages for business. SAGIA is also working with leading environmental institutions to ensure that the Economic Cities are developed with minimum negative environmental impact and maximum energy efficiency and sustainability.
- Excellent infrastructure
- Private sector development and management of zones

New Trends in MENA: Following the Trend

Iraq's Vision for Economic Development Zones: the move away from classical EPZ & municipal industrial zones towards more comprehensive Economic Development Zones

- Link b/w national development strategy and sector development policies
- Gov provision of off-site infrastructure with private sector development & management of zones
- Independent EDZ authority as regulator
- State of the art information technology and telecommunications
- Vocational training institute, with human resource recruitment system (shelter plan)
- Institutional architecture – range of professional institution and business associations
- Cluster of technical and support services (e.g. quality and productivity center business incubator, technical extension services specialized companies for quality standards and testing, R&D center focused on particular industry of the BDZ)
- One stop shop services
- Onsite residence

New Trends in MENA: Following the Trend

Oman's new special economic zone

- Private sector development and management of zones
- Industrial and petrochemical projects, warehousing and logistics services and soft investments like educational and medical facilities
- no minimum capital requirements, 100 percent foreign ownership, free repatriation of capital and profits, relaxed corporate tax holiday, competitive land lease tariffs, and duty exemptions on imports and exports
- Permits and approvals would be processed expeditiously through a one-stop-shop arrangement, according to the Observer report.
- Investors would also "enjoy a host of competitive advantages by virtue of the SEZ's strategic geographic location outside the Strait of Hormuz, and its access to world-class logistics"

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Possible Constrains to the Success of EZs in MENA

General Policy Framework

- Complacency with zone reforms does not allow to extend to wide economy reforms.
- Weak links between industrial, export and investment and zone strategies; in many cases zones are uncoordinated development initiatives.
- Unaligned strategies lead conflict between Zone authorities and Investment Promotion Agencies.
- Possible constraints imposed by WTO rules on the use of performance requirements (export subsidies and export requirements) if GNI surpasses the USD 1,000 threshold.

Regulatory Framework

- Private sector role is not sufficiently facilitated.
- There is a general lack of transparency in most processes for both investors and private developers, eg. Land designation, bidding processes, selection criteria.
- Proper legal infrastructure for PPP financing is lacking.

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Possible Constrains to the Success of EZs in MENA

Incentive Framework

- Despite the reliance on other incentives, MENA governments still resort to excessive tax incentives without the use of sunset clauses, leading to windfall gains.
- The need to avoid undue competitive disadvantages among firms (e.g. domestic firms outside zones)
- The lack of thorough cost benefit analysis of incentives being used.
- A country's situation where some zones have tax incentives and others don't leads to competition among free zones based on tax incentives thus creating distortions. Incentive packages are not sufficiently encouraging linkages with the local economy and sometimes impede them.

Design and Facilities

- Land designation and land allocation processes are not well established.
- Off-site infrastructure is not well developed for zone sites.
- Utilities provision is not reliable.
- Lack of business development services such as quality control and standardisation .
- Lack of efficient promotion and marketing of zones

General OECD Recommendations for Economic Zone Development : Rule of Thumb

In order for economic zones to succeed in achieving their intended policy objectives, **they should not be used as a substitute for a country's larger trade and investment reform efforts**

Economic Zones **should be used as pilot and demonstrative projects** with the aim of encouraging broader economy-wide reforms

The success of Economic zones depend **on the extent to which they create linkages with the local economy** thereby generating employment and increasing transfer of know how

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Suggested Elements for Designing Effective EZs in MENA

1. Minimise reliance on corporate income tax incentives;
2. Improve one-stop-shop services by zone authorities;

(Administrative facilitation has become highly valued by investors)

From CCA model: for Egypt Average annual profits can be up to 12% higher for firms with minimal license and approval delays

	Estimated average annual firm cash flow by sector ('000 USD; annual average over 10 years)			% difference between best practice and Egypt average
	Egypt average start-up	Zone average start-up	Egypt best practice start-up	
Furniture	478	526	546	12.51%
Leather	315	346	358	12.09%
Chemicals	13,955	15,284	15,839	11.89%
Food and beverages	12,460	13,641	14,135	11.85%
Textiles	10,968	12,006	12,441	11.84%
Metal production	14,246	15,592	16,155	11.81%
Plastics and rubber	4,403	4,819	4,992	11.80%
Mechanical machinery	6,138	6,715	6,957	11.78%
Basic metals	24,815	27,147	28,124	11.77%
Wood production	7,682	8,404	8,706	11.76%
Fuels and fertilizers	10,596	11,591	12,008	11.76%
Transport equipment	14,547	15,913	16,484	11.75%
Electrical machinery	36,581	40,007	41,440	11.73%
Garments	7,602	8,314	8,612	11.73%
Glass, pottery, etc.	12,226	13,368	13,846	11.69%
Average across all firms	**12,590**	**13,778**	**14,275**	**11.80%**

Suggested Elements for Designing Effective EZs in MENA

- Increase linkages with the local economy; “equal footing” policies for domestic suppliers of capital and intermediate goods and the extensive use of sub-contracting by zone based firms to local producers.
- Facilitate the role of private sector in zone development;
- Support private sector-led development of clusters.
- Abide with WTO obligations regarding performance requirements by using an ‘export competitiveness’ assessment criteria in the screening and approval process:
  - Investment project’s output penetrates new markets outside Egypt
  - Investment project’s output increases Egypt’s global (or regional) market share for a particular project
  - Project’s output feeds into a global supply chain
- Set up effective administrative structures
- Conduct Cost/benefit analysis and ensure that zones are sustainable in the long run.
- Strengthen the link between the national development strategies and sector development strategies. Yes they are enclaves but should not be separated from the development objective of the country.

Way Forward

- Develop a Handbook for Economic Zone Development building on the Guidelines and showcasing best practices from the region, competitor markets and the world.
- Country specific projects for assessing or creating new Economic Zones.

Annex: Guidelines for Zone Development

I. Zone Type

1. **Zone regimes should not be limited to a narrow set of sectors;** the global trend is the increasing convergence of the traditional export processing zone concept with free trade zones into zones with a multi-sectoral development approach; e.g. Jordan's Aqaba SEZ.

2. **A common set of incentives and privileges for all zone types is encouraged.** This would reduce the overlapping of zone regimes that confuse investors and undermine zone programmes;

I. Zone Type

3. **Greater involvement of the private sector in the development of zones should be encouraged;** international experience reveals that a significant number of government developed and managed zones have been less effective than their private counterparts.

Egypt's new "Investment Zone" regime allows for the private sector to establish, manage and promote these zones.

Kuwait's Free Trade Zones (KFTZ) were established and managed by the privately owned National Real Estate Company.

Libya is pursuing a private sector involvement whereby Dubai's JAFZA International has signed an agreement with the FTZ authority committing both sides to explore the possibility of forming a joint venture or granting JAFZA a 30 year concession over the FTZ.

Morocco is further developing its second free zone in cooperation with Dubai based JAFZA

Oman is developing the Knowledge Oasis Muscat as a public-private sector led technology park.

II. Policy Framework

Policy frameworks should be streamlined and should compete on the basis of facilities and services rather than on provision of incentives

1. **Realistic expectations should be set and thorough cost benefit analysis should be conducted**; determining whether it is more efficient to have private sector or public sector development of zones;

2. **Competition between public and private zones should be avoided** by aligning incentives among zones;

3. **Clear physical development standards and criteria for approval of privately and publicly developed zones should be put in place and streamlined**;

4. **Zones should be eligible for national certificates of origin** to be able to participate in trade and market access agreements;

II. Policy Framework

6. **Minimum export requirement should be removed** in order to maximize the flexibility of the regime and abide by WTO obligations;

7. **The principle of non-discrimination should be respected in free zones** by not discriminating between foreign and domestic investment projects thereby increasing FDI;

8. **Labour regimes should be consistent with international norms including ILO standards and obligations**, as to increase the quality and productivity of its workers;

9. **Indirect exporter benefits (i.e. duty free access to the zones) should be given to firms in the local economy which supply firms located in the zone** thereby increasing linkages;

10. **Collaborative relationships should be encouraged between investment projects in the zones and firms and research institutions in the local economy**, by developing business networks and clusters.

II. Policy Framework

Selected MENA Policy Frameworks for Economic Zones

The policy frameworks in several MENA countries provide for equal treatment of foreign and domestic investors, increased linkages with the local economy and national certificates of origin.

Egypt, Iraq, Kuwait, Palestinian National Authority, Syria, UAE and Yemen all permit 100% foreign ownership.

National certificates of origin are provided in Egypt's Suez Special Economic Zone and in Jordan's free zones.

To increase linkages with the local economy in Egypt, all the local components of the products produced in the free zones are exempt from any customs duties in the case of their selling to the local market (inside the country); and exports and imports of the project to and from the country are exempt from any sales taxes or any other kinds of taxes or duties applied in the country.

UAE and Jordan do not apply minimum export requirement in their zones.

III. Incentive Framework

The use of incentives should be consistent with the agreed upon "Conclusions of the MENA Task Force on Incentives, 29-30 June"

1. **Tax incentives inside zones should be harmonized with the national tax system;** thereby leveraging the introduction of zone reform for achieving overall tax reform;

2. **The use of performance based incentives should be through a country's tax code rather than through special legislation**; as to increase the effectiveness of tax administration;

3. **Where tax incentives are offered, the introduction of sunset clauses is encouraged;** as long term commitments create equity problems. Various MENA countries have introduced such clauses when granting incentives.

IV. Regulatory Framework

A crucial aspect which is often overlooked is the simplification and streamlining of investment approvals, expatriate work permits, granting of import and export licenses, accelerated customs inspection and automatic foreign exchange access.

1. **A simple declarative investment registration system is encouraged;** where applications should be submitted to a single government office that provides the license;

2. **Criteria for approval or denial should be made public and a list of ineligible activities should be used instead of specifying only eligible activities** as to guarantee transparency;

3. **Provision of secondary permits and authorizations should be facilitated** by allowing one relevant authority to grant such authorizations.

V. Institutional Framework

A major factor contributing to the success of zone programmes is the autonomy and effectiveness of the body charged with overseeing zone operations

1. **Sufficient autonomy of the zone authority over staffing, budgets, spending and policy making should be ensured and clearly stated in the law;**

2. **An independent board composed of representatives of all key involved ministries and the private sector should be formed,** thereby ensuring customer focus**;**

→ An example of this is Egypt's SEZ regime; the zone is self-governed through an independent authority with even greater authority granted to the Board of Directors. The board is composed of government and private sector representatives.

V. Institutional Framework

3. **One-stop shops should be set up by the zone authority in each of the zones,** to provide all necessary assistance, licenses and approvals; most of MENA countries have established one-stop shops in their zones such as Bahrain, Djibouti, Egypt, Jordan, Kuwait, Lebanon, Morocco, Tunisia and UAE.

4. **Non-core functions and services should be outsourced and privatized as much as possible** thereby allowing the government to focus on core functions especially its regulatory role.

VI. Physical Development and Management

The choice of location is important in determining the extent of off-site infrastructure expenditures of the government. Some locations are already situated near existing infrastructure thereby minimizing the costs to be incurred by public authorities.

1. **Land use planning and zoning should be implemented in defined areas for industrial and commercial development to attract private developers;**

2. **Zone designation criteria should be incorporated in the zone law in addition to implementing regulations to ensure that private zones are conveniently located;**

VI. Physical Development and Management

3. A land use planning and infrastructure development unit should be established in the government to ensure adequate planning and support of off-site infrastructure provision;
4. Zones should be managed on a cost recovery basis and should be customer focused. Cost recovery basis is enhanced by limiting subsidies and charging fees that are based on market prices.

Thank you

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