OECD EURASIA COMPETITIVENESS PROGRAMME

Stocktaking of Good Practices for Free Economic Zone Development

Working Group on Investment Climate Policy and Promotion

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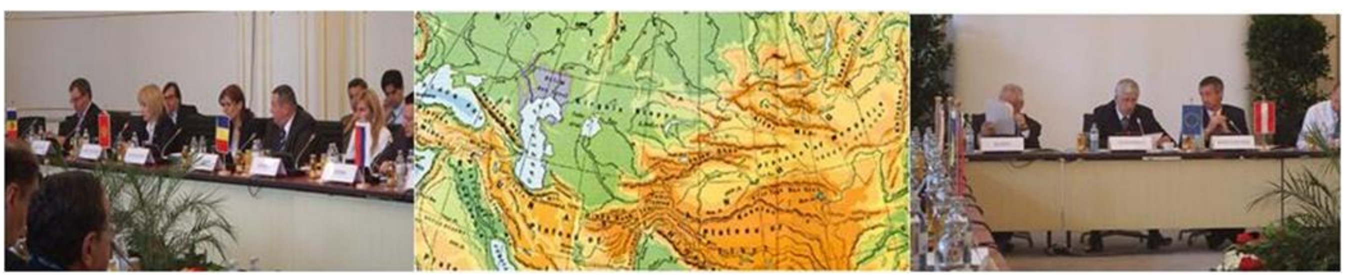


Good practices for Free Economic Zones Development

Overview

Why Special Zone Programmes?

4 Key Trends

1. **Zone Types**
2. **Policy Framework**
3. **Incentive Framework**
4. **Regulatory Framework**
5. **Institutional Framework**
6. **Physical Development and Management of Zones**
7. **Example of OECD work on Zones in Egypt**

Why Special Zone Programmes?

Zones are **second best solutions,** they create distortions with **"positive discrimination"** of companies

However: many countries face institutional capacity challenges. Need for:

- **Focusing of scarce resources**
- **Implement good practice as model**
- **Export or cluster focus can be legitimate**
- **What are competing locations doing?**

Why Special Zone Programmes?

In order for economic zone programmes 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**

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

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

4 Key Trends

1. Use of **private zone developers**, governments restricts its role to regulation and off-site infrastructure provision

2. Permit zone development in the whole country. Treat new zone applications like any large scale property developments

3. Emphasis is on integrating zones **into the domestic economy**

4. Less use of **tax incentives**, emphasis on facilitation and infrastructure provision

I. Zone Type Designing

1. **Key problem can be overlapping Zone models**: confusing for investors, difficult to manage/regulate

2. **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 or Egypt Suez SEZ. **However: all types of theme Zones possible** offering customized infrastructure, but common set of indicators required.

I. Zone Type Design

3. **Issue of “large format” SEZs**, trend to encourage them, Shenzhen SEZ in China attracted 30 bn $ in FDI. But: administering is difficult, Aqaba SEZ has 800 staff….

4. **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

5. **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. (See Annex)

III. Incentive Framework

The use of incentives should be reconsidered

A mature system features:

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 countries have introduced such clauses when granting incentives.

Example of recommendations to major Arab country

1. Phase out preferential CIT in FZs and SEZs for new investments according to the below schedule;
2. Introduce a 10% research, development and adoption (RDA) tax credit for investment in qualifying expenditures by companies in FZs and SEZs.

FZ Phase-out

Introduction of 10% RDA

SEZ Phase-out

Tax Year	FZs	SEZs
2009	0%	10%
2010	10%	10% (no change)
2011	10%	10% (no change)
2012	12%	12%
2013	14%	14%
2014	16%	16%
2015	18%	18%
2016	20%	20%

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; as an example, 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.

VII. Example of OECD work on Zones in large Arab country

A four-pronged approach was used

Country missions	A series of fact-finding missions were conducted between November 2008 – May 2009 to gather information and interview key players and stakeholders, e.g. zone investors and authorities
Best practice survey	A survey of OECD and MENA best practices was conducted on current policy tools used within international zone programmes
OECD Committees consulted	Recommendations had to be aligned with OECD tax and investment committees best practice recommendations and 2 MENA regional policy dialogue meetings (Working Group 1) were held to accumulate best practice on zone policies
CCA	The Company Competitiveness assessment (CCA) was developed by the OECD to identify policy areas critical to the profitability of different types of companies (see Annex 1)

Company Competitiveness Assessment (I)

OECD can transfer the CCA to the Zone Authority which will help to determine threshold levels and firm eligibility

Methodology

Simulates a firm's profit and loss, cash flow and balance sheets over 10 years

- Capacity, or production level, is modelled using an "S-curve"
- Data on firm accounts is collected by the World Bank Enterprise Survey for Egypt (2007) and includes initial capital investment, investment in buildings, revenue, labour costs, input/raw material costs, utilities costs and transport costs.
- Profitability is determined by sum of the stream of net profits plus depreciation over ten years

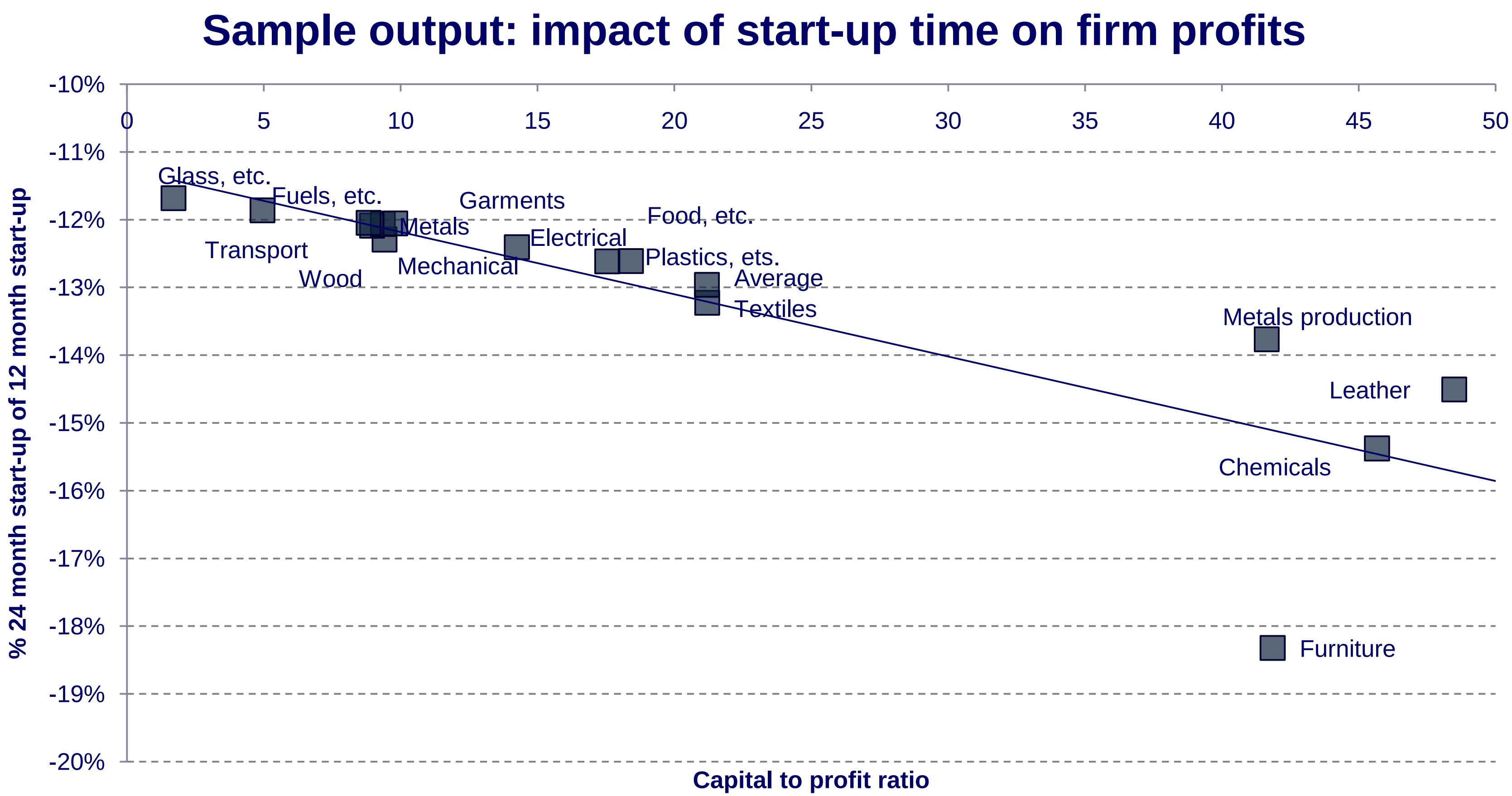
Assumptions

Various assumptions are employed, including (unless otherwise stated; list is not exclusive):

- Investment in equipment/machinery and buildings is made upfront
- No-reinvestment is made over the 10 year lifecycle
- Initial investment is funded 50% from equity and 50% from loans
- 100% of inputs are imported
- 100% of production is exported

Company Competitiveness Assessment (II)

The CCA allows for breakdowns on the impact of certain policy levers by industry and size of firm



Recommendations

1. Minimise reliance on corporate income tax incentives;
2. Improve one-stop-shop services by zone authorities;
3. Increase linkages with the local economy;
4. Facilitate the role of private sector in zone development;
5. Support private sector-led development of clusters.

Thank you

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