

### The Investment Promotion Zone

In March this year, the Greater Colombo Economic Commission announced a range of incentives to investors in the Investment Promotion Zone to be located in Katunayake — the first of several such zones that will be established under this Commission. Shortly afterwards it was announced that the applications of 20 investors had received approval and 4 enterprises had signed agreements with the Commission. A total of 70 applications and inquiries had been received for setting up projects in the G.C.E.C.

The idea of establishing an Export Processing Zone was also mooted in the early 70s but for reasons not divulged the then Government abandoned it at a later stage. The present Government however, at the general elections of

1977, obtained a popular mandate to establish an Export Processing Zone or a number of such zones within the country. Within less than a year the Government has completed the preliminary work required to establish one such zone in an area north of Colombo.

This Investment Promotion Zone is approximately 600 acres in extent and is located approximately 18 miles from the port of Colombo, adjacent to the Colombo International Airport at Katunayake.

The main objectives of the Greater Colombo Economic Commission are to encourage foreign investment, to induce industrial and commercial enterprises, to enhance export earnings and to facilitate employment and general development of the entire area within its authority. The establishment of an

Investment Promotion Zone under this Commission is considered one of the key strategies for solving the economic problems of the country by the present Government; it is also a step towards an "outward looking" development strategy in accordance with which the Government has already liberalised exchange and import controls and opened up the economy for greater export—import trade transactions.

The concept of an Investment Promotion Zone is analogous to terms such as Export Processing Zone and Free Trade Zone. According to the United Nations Industrial Development Organization (UNIDO) definition, such zones involve "the establishment of modern manufacturing plants inside an industrial estate by offering a suitable package of investment incentives to both foreign and domestic entrepreneurs". In general, the goods produced in such zones are meant for export.

In a number of countries around the developing world, there are instances where Free Trade or Export Promotion Zones are established. Asian examples are: India (2 Zones), Korea (2 Zones), Indonesia (1 Zone), Taiwan (3 Zones), Korea (2 Zones), Philippines (1 Zone) and Singapore (almost entirely a Free Trade Zone). The objectives of these different countries in setting up these Zones have, generally been the same, as indicated with respect to the objectives of the Greater Colombo Economic Commission.

From an economic point of view the success of a Free Trade Zone would depend basically on the ability to attract a substantial amount of investment into the Zone. It is for this purpose that various incentives such as tax holidays, concessionary import duties and other infrastructure facilities are provided for the investors. In this context, the Greater Colombo Economic Commission announced the following incentives to investors in the Katunayake Investment Promotion Zone:

- (1) Industrial sites within the Zone will be made available to investors on a 99 year lease basis on the payment of a initial premium plus an annual nominal quit rent.
- (2) The Commission will provide adequate and modern infrastructure facilities to the area

demarcated as the Zone. This would, in addition to services like water, power and roadway include an air-cargo terminal and container marshalling yard for sea going containers, a rapid and sophisticated telecommunication system and special banking facilities.

- (3) Investment incentives will be offered on a graded scale, i.e. according to the siting of the factory in the Zone, creation of employment, export orientation, capital investment and development of technology.
- (4) All imports of equipment, construction materials and other materials and other imports (except general transport vehicles) would be free of import duty while import and export activities would be free from control.
- (5) A five year tax holiday will be granted from the date of commencement of commercial production.
- (6) After the expiry of the tax holiday period, income tax on the turn-overs will be at 2 per cent on sales to other countries, and 5 per cent on sales to Sri Lanka.
- (7) There will be a 10 per cent withholding tax on all remittances of royalty and technical service payments after the tax holiday period.
- (8) All foreign personnel attached to the projects would be exempted from all taxes for the period of tax holiday of the particular project.
- (9) All dividends paid to non-resident share-holders of the projects would be free from further taxes and all exchange control.
- (10) Investment agreements would include guarantees for the free transfer of capital and returns as well as all the proceeds of liquidation.
- (11) The shares of incorporated companies could be transferred to residents or non-residents and such transfers would not be subject to any tax or levies in Sri Lanka.
- (12) Foreign banks will also be permitted to operate within the area of authority and will be entitled to a 5 year tax holiday period and a tax rate of 5 percent on profits thereafter;

and off shore banking profits and approximately 25 per cent on general banking profits.

The range of facilities, concessions and financial incentives listed above, as extracted from the total package deal spelled out by the Greater Colombo Economic Commission, indicates the extent of willingness of the host country to attract investors into the Investment Promotion Zone to promote export oriented industrial development in Sri Lanka. In offering this range of incentives, Sri Lanka has acted on the assumption that the key factor that attracts foreign investors is the fiscal and financial incentives extended by the host country.

There are however factors other than the tax concession and financial incentives that tend to influence the decisions to invest and the location of investment. The socio-political and economic stability of the host country is one such important factor. Also, studies on Free Trade Zones have revealed that the efficiency of the administration of the Zone could be more important than the package incentives offered by the host country. Thus, the flow of foreign investment into the proposed Investment Promotion Zone in Sri Lanka would be influenced by the impressions that Sri Lanka has created in the outside world with respect to the country's capacity to sustain socio-political and economic stability and the country's ability to administer a Free Trade Zone efficiently. The word "stability" in this context has hitherto meant in practise the conditions in such countries as South Korea, Taiwan, Phillipines and Singapore which are not Western style democracies.

There are several other factors that enter into the calculations of foreign investors in their decision making. One of the basic principles of locating an industry in a Free Trade Zone of a developing country by a foreign firm is the comparative advantage of producing a particular commodity at a relatively lower cost. In fact, the range of fiscal and financial incentives granted by the host country to foreign investors is also aimed at contributing to this comparative advantage. However, the key element in securing low cost production, especially in an export oriented product, is the availability of relatively cheap but skilled and semi-

skilled labour required for production. Another similar element would be the availability of raw material or some other input that is essential for a given product at a relatively low price.

To the extent that industrialists are attracted to the Investment Promotion Zone due to the availability of cheap labour and raw materials in Sri Lanka, the expansion of industry in the Zone would benefit the country in terms of employment creation; that is, if investment in the zone is not at the expense of investment elsewhere. Similarly, the spread effects and the backward linkages of industrial growth would also be greater particularly, when local raw materials are used.

As of this date, there have not been any estimates made available by the Greater Colombo Economic Commission with respect to the cost of providing infrastructure facilities, anticipated flow of investment, expected number of job opportunities and projected export earnings associated with the Investment Promotion Zone. As such, it is difficult to evaluate the targets and the prospects for achieving these targets. For instance, the employment potential within the zone has been variously estimated at numbers ranging from 100,000 to 15,000. The capacity of the zone to generate job opportunities, however, would depend partly on the volume of total investments attracted and partly on the volume of capital required to generate each job opportunity. There is also the crucial factor of technologies adopted by the investor which is not easy to control.

However, it can be judged by the statements of Government spokesmen that great faith has been placed in the Investment Promotion Zone to act as a major project in Sri Lanka's economy so that rapid industrial growth, higher export earnings and a greater number of employment opportunities will be facilitated by this strategy. The socio-political as well as economic costs of this strategy, however, are yet to be identified.

Questions such as the impact on national sovereignty, the intervention, in the local economy by multinationals and giant foreign firms, the environmental pollution resulting from industrialisation also have not been adequately examined. The most fundamental issue raised is how far this concept effects self-sustaining and independent development.