

FEATURES

THIRD WORLD EPZ'S ZONES OF SPECIAL INTEREST

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Export Processing Zones (EPZs)—the special manufacturing enclaves set up to attract foreign investors, often using lavish tax, customs and labour incentives as bait—have boomed since the 1960s, despite some economists' doubts about their benefits. Socialist, capitalist, developed and developing countries have jumped on the bandwagon, though with varying degrees of success.

Free ports, where goods can pass in and out tax free, go back centuries. EPZs, by contrast, offer concessions only where goods passing through the zone undergo some process that adds value. The first recognised EPZ was set up at Shannon airport in Eire in 1959.

Mauritius now offers EPZ facilities on industrial estates throughout the country. Mexico's are mainly sited near the US border. The whole of Hong Kong is in effect an EPZ, though extra facilities are offered on some industrial estates to encourage investors. China has four special economic zones in addition to Hainan Island, plus several free ports authorised to offer investors tax and tariff concessions.

As the number of EPZs has risen, so has the competition for foreign investment. All EPZs waive customs duties on imported raw materials and other goods if the final product is sold elsewhere. But there are other incentives, too, ranging from long tax holidays on profits to subsidised rents and services, Swiss-style bank accounts and an absence of bureaucratic controls.

Some offer investors unrestricted repatriation of profits. Others have their own administrative authorities, their own infrastructure, separate banking facilities and even their own commercial policy. Sometimes strikes are banned and minimum wage laws waived. Sri Lanka has given up its constitutional right to nationalise foreign companies.

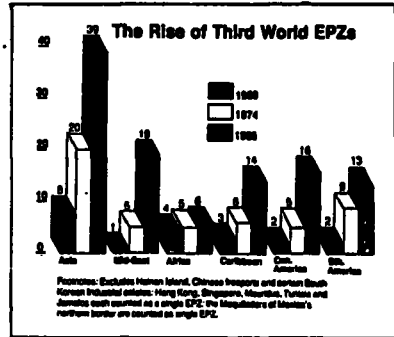
Behind this enthusiastic embrace of EPZs by developing countries lies a broad shift away from import-

substitution industries—which mean greater self-sufficiency in favour of exports and closer integration with the world economy.

Some, though, have balked at the kind of liberalisation involved. India and China have sought to obtain the benefits of free trade without dismantling protectionist barriers and exposing local industry to international competition. They have had limited success.

"EPZs are one of the rungs on the ladder for countries that don't have much experience with foreign investment," a Washington expert says. "They are a proving ground for new development policies, a way to experiment with reducing the dead weight of unnecessary protectionism and red tape."

Transnational and other investors see cheap labour as the key attraction of EPZs, where wages are usually 10 to 30 times lower than in industrialised countries, though this has not stopped the outbreak of a big incentives war among host countries.



Protectionism in North America and Europe has also added to the attractions of EPZs for foreign investors. For example, under the tough international agreements governing Third World textile and clothing sales to the West, export quotas have been imposed on all the main developing country producers. Some Third World producers and western companies have set up business in countries which have failed to fill their sales quotas.

Under US tariff rules, goods can be exported for assembly abroad and returned at favourable rates. Tariffs are levied only on the value added during processing overseas.

US companies are the most

important source of investment in Third World EPZs, especially in Latin America and the Caribbean. Japanese and Australian investment is concentrated in Asia. European investors are to be found in Asia, Africa and the Middle East. Increasingly, such newly industrialising countries as South Korea and Hong Kong are investing in zones elsewhere in Asia.

Textiles and electrical and electronic goods assembly account for about 80 percent of jobs in EPZs. Other products include footwear, leather goods, optical equipment, toys, plastics, sports equipment, motor parts and minor transport equipment. Capital goods and hi-tech products remain rare.

According to some, special zones in the North and South account

for US\$ 170 billion of trade, about 9 per cent of the world total. Their share is predicted to more than double in the next few years.

Many developing countries have found that EPZs are no magic short-cut to export-led industrialisation. The failures far outnumber the successes.

Success can depend on so many factors—a country's accessibility, its proximity to key markets, reserves of cheap labour, political stability and, above all, commitment to open trade that no single model can be considered ideal, the Paris-based Organisation for Economic Cooperation and Development says. In many cases there is a big risk that the cost of EPZs will outweigh the benefits, making them a drain on scarce resources.

Some countries already imbued with a free-trade philosophy, notably South Korea and Taiwan, have exploited EPZs to secure foreign capital and technology. India and China, which have adopted a more piecemeal and equivocal approach to opening up their economies, have been far less successful.

Panama, Hong Kong and Singapore have harnessed the advantages of entrepot trade to promote EPZs. But such latecomers as the Philippines, Sri Lanka and Indonesia have done less well.

Mexico's EPZs, sited near the US border, have continued to attract investment. But further south only Panama's EPZ is prospering, according to a recent study by the London-based Economist Intelligence Unit.

Zones in South America have done little to promote export industries. In the Caribbean, they have progressed only in the Bahamas. Those in the Middle East have also been disappointed. EPZ activity in sub-Saharan Africa has been relatively insignificant.

Despite the limited number of successes—and Mauritius is another that figures on the list—the EIU's recent study says EPZs "can make a useful contribution to economic growth". However, it, too, concludes that they are "usually unsuited to be the major foundation for economic development".

A recent study by the International Confederation of Free Trade Unions is harsher in its conclusions, arguing that the benefits of most EPZs have been minimal at best. "In practice, foreign investment gains are limited; balance of payments positions have not improved; the zones attract a mono-structure type of manufacturing, often only part processes; zones worldwide have created no more than 1 million jobs; linkages with the domestic economy are limited and technology transfer has generally not taken place," it says.

A sceptical report produced by Unctad in 1983 urges Third World countries to "assess carefully the benefits and costs" of EPZs. Even the secretariat of the OECD, representing the rich nations that provide Third World EPZs with most of their investment, has expressed doubts—notably about the generous tax concessions

When generosity fails to convince

The Philippines and Sri Lanka have secured less from EPZs than they anticipated. Both have attracted some foreign investment, but mainly in footloose labour-intensive, low-tech industries.

Neither has begun to emulate the South Korean and Taiwanese models by inducing more diverse and long-term investments in capital-intensive heavy goods — where value added is highest and foreign exchange earnings greatest.

Sri Lanka has gone as far as any country in offering a wide range of generous inducements to foreign investors. These have gone beyond financial inducements; after the election of the pro-western United National Party in 1977, strikes were outlawed, union activity curtailed, investment guarantee pacts signed with several countries and the constitution changed to preclude nationalisation of foreign companies.

The Philippines used martial law, introduced in 1972, to solve bureaucratic bottlenecks and steamroller opponents of EPZs, many of them peasants whose villages were being displaced to make room for the zones. Strikes were also banned under martial law.

Today, though, the Philippines is scaling down plans for more EPZs. "Major international companies have delayed expansion plans, so we are delaying ours," the administrator of the local EPZ authority says. Prime Minister César Virata has hinted at a more thorough policy review. "Zones are expensive," he says. "Why be efficient only in certain enclaves? Why not make the whole country efficient?"

All this compares with earlier hopes that the EPZs would help the Philippines to resolve its balance of payments problem by bringing in foreign exchange and technology. Initial earnings and jobs estimates have proved highly optimistic, and the country's

financial crisis has dampened hopes that the zones would be filled quickly.

The government has spent heavily on roads, telephone lines and other infrastructure around the zones, but transport remains a problem, along with the isolated location of some zones.

Few benefits have been secured. The zones are still importing most of their raw materials and have established few links with the rest of the economy. In the Bataan EPZ — the oldest — several companies have failed; employment at the end of 1983 was no higher than in 1978.

Sri Lanka had more initial success in attracting investment, but much of this was by companies seeking to exploit the country's unused export quotas to the West.

About 80 per cent of EPZ operations — 86 per cent of jobs in the zones and an even higher percentage of earnings in 1981 — involved garment manufacture. There was little technology transfer and the level of investment per company was low.

Two factors have undermined the zones in Sri Lanka and the Philippines: political instability and a failure to convince potential investors of their long-term commitment to free trade. In Sri Lanka, the opposition has promised to nationalise some foreign investment once restored to power.

Because of automation in the formerly labour-intensive electronic industry, investors have gravitated towards areas where capital is most abundant. This means that such relatively high-wage countries as South Korea and Taiwan can still compete.

Some western and Third World companies have moved into lower-wage countries, but more are now staying at home, which means that the newer EPZ operators have come on to the scene too late. □

Monica Feria in Manila
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offered by some host countries.

The OECD says investors are impressed less by special concessions than by the overall business climate in a country. This would include factors like the political scene, the amount of government regulations and the like. That explains why such countries as Sri Lanka- where the opposition may reverse current foreign investment policies if it gains power- can find it difficult to attract foreign capital.

The 11-year-old Dakar zone in Senegal had only a handful of companies by last year. Additional incentives have been offered, but there have been few takers. The zone at Kingston, Jamaica, where infrastructure has been improved with the help of World Bank money, has attracted only seven manufacturing firms in eight years. It employs less than 1,000.

Even when investment is forthcoming, there is no guarantee that the host country will achieve its objectives: bigger capital inflows, more jobs, increased foreign currency earnings, the transfer of technology and speedier industrial development.

Capital inflows: Critics say foreign investment in EPZs contributes little to the host country's capital stock, largely because the zones tend to attract labour-intensive assembly operations and simple processing.

Companies in the North send materials or components to subsidiaries in the EPZs, and the assembled products are then returned or exported to third countries.

Capital investments by foreign companies in EPZ production sites in the 1970s rarely exceeded US\$ 1 million; many fell far short of US\$ 500,000.

Unctad says that capital investments of more than US\$ 5,000 per job created have been the exception. In electronics and clothing, both of which figure prominently in EPZs, investments have often been limited to sewing machines or soldering irons and microscopes.

Host countries, by contrast, have spent heavily on roads, buildings and utilities in EPZ sites. Where land and factory space have been provided cheaply, host countries' returns may fail to cover capital and operating costs.

Jobs: Eighteen of the 35 countries included in the EIU study have seen employment rise in their EPZs since 1978. However, Unctad puts total employed in Third World EPZs at less than 1-million- 2.6 per cent of the officially registered industrial workforce in the Third World.

This is insignificant compared with the hundreds of millions unemployed. Nor is it clear whether EPZs are creating new jobs or simply transferring employment from other areas. In Mauritius, Singapore and Haiti, EPZs employ 35-55 per cent of the total working in manufacturing, the ICFTU says.

Eighty per cent of EPZ workers are women between the ages of 16 and 25. This can cause social problems. In Mauritius the labour force increased by about 10,000 a year in 1975-82, but job opportunities for men in the dominant sugar industry declined. Of 12,200 new jobs in the EPZs, the main growth sector, 2,400 were for men, the EIU says.

The ICFTU says the EPZs are "based on the exploitation of low-cost labour and the avoidance of social responsibilities such as health and safety regulations and the recognition of trade unions".

Transnationals are attracted because they can "hire and fire workers at will," it says, nothing how half of the 40,000 employed in Mexico's EPZs were laid off during the 1974-75 recession.

Foreign exchange earnings: Because EPZs involve a high level of imported raw materials and components, the net foreign exchange benefit is often low.

Profits are often untaxed, so the main gains to the host country come in the form of wages, factory rents or electricity, water and transport tariffs- assuming these are economically priced.

With exceptions only in South Korea, Taiwan and Colombia, the net import content of goods produced in Third World EPZs is about 60 per cent or more of the final price, EIU figures show. In Sri Lanka it was 68 per cent in 1983 and in the Philippines 73 per

cent in 1982. In some industries, electronics for example, it is even higher.

Wages account for 10 to 18 per cent of the sale value of EPZ products, according to some- and for more than 70 per cent of what host countries earn from the zones, Unctad says.

However, some have done much better than this. In the case of the Masan EPZ in South Korea, local value added rose from 28 to 52 per cent of export value between 1971 and 1979. The local material share of value added rose from 6 to 47 per cent in the same period, OECD figures show.

EPZs account for less than 5 percent of total manufactured and semimanufactured exports by developing countries, Unctad says. Again some have done better. EPZ exports accounted for more than 90 per cent of all non-traditional exports by Mauritius in 1979, for example, Technology transfer and training: Because EPZs attract labour-intensive industries, technically sophisticated production processes are rare.

Pre-assembly, which may require advanced technology, remains located in the industrialised nations, where most research and development takes place. In semiconductor manufacturing, for example, the two hi-tech aspects of production-mask-making and wafer fabrication-are normally undertaken in the home country of the foreign investor.

The monotonous nature of the work in EPZs provides little scope for training. The Chinese, however, insist that managers chosen for joint ventures in its special zones should eventually take their experience and know-how to factories elsewhere.

Industrial development: Because of the high import content of what they produce, the EPZs are mainly linked to the rest of the host economy through the services and construction industries. The wages paid by companies in EPZs have a multiplier effect when they are spent on local consumer goods. Such so-called backward linkages are limited.

To be continued in next issue.