SPECIAL ECONOMIC ZONES (SEZs)

• Special economic zones (SEZs) aim to overcome barriers that hinder investment in the wider economy, including restrictive policies, poor governance, inadequate infrastructure, and problematic access to land. SEZs tend to offer export-oriented investors three main advantages relative to the domestic investment environment: 1) they offer a special customs environment including efficient customs administration and (usually) access to imported inputs free of tariffs and duties; 2) they have historically offered a range of fiscal incentives including corporate tax holidays and reductions, along with an improved administrative environment; and 3) they provide infrastructure (including land, factory shells, and utilities) that are more accessible and reliable than would normally be available outside the zones.

• SEZs have a long-established role in international trade. Prior to the 1970s, most zones were clustered in industrialized countries; but since the 1980s, there has been massive growth in SEZs in developing countries, led at first by East Asia and Latin America and more recently by the development of new programs in Central and Eastern Europe, Central Asia, the Middle East, and North Africa. Recent estimates indicate that there currently are more than 3,000 SEZs established in some 135 countries. Overall SEZs are estimated to account for more than US$200 billion in global exports and employ directly at least 40 million workers.

• Most zones set up in the 1970s through the 1990s were designed to attract investment in labor-intensive assembly and manufacturing from multinationals. These export processing zones (EPZs) were a cornerstone of trade and investment policy in countries shifting away from import-substitution and in favour of integrating into global markets. Among the multiple objectives normally being sought as part of these policies were: job creation, growth in exports and foreign exchange earnings, facilitating economic diversification (often as a step in processes of industrialization and industrial upgrading) and access to foreign manufacturing technology and know-how.

KEY ISSUES AND CHALLENGES

• In some countries, SEZs have been a powerful instrument for economic growth and structural transformation. For many of the initial zones in East Asia, zones proved played a critical role in facilitating the industrial development and upgrading the ‘tiger’ economies. Similarly, the later adoption of the model by China provided a platform for attracting FDI and not only supported the development of its export-oriented manufacturing sector, but served as a catalyst for sweeping economic reforms that were extended throughout the country. In Latin America, countries like Dominican Republic, Honduras, and El Salvador used free zones to take advantage of preferential access to US markets, and have generated large-scale manufacturing sectors in economies that were previously reliant on agricultural commodities. Finally, in Africa, SEZs are credited with enabling Mauritius to move from dependence on sugar to become a manufacturing hub and eventually an innovative, middle income country.

• However, there are also many examples of failures of SEZs, where investments in zone infrastructure resulted in ‘white elephants’ or where zones have largely resulted in industry taking advantage of tax breaks without producing any substantial employment or export earnings. Moreover, many zones that appear to have been successful in the short term, have failed to remain sustainable once labor costs have risen or when preferential

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1 The term “SEZ” is being used here in a generic sense to cover any one of a variety of similar regimes including ‘industrial free zones’, ‘special economic zones’, ‘maquiladoras’, ‘export processing zones’, ‘investment promotion zones’, ‘foreign trade zones’ and ‘free zones’
trade access is no longer an advantage (e.g. following the end of the Multi-fiber Agreement). Zone failures can be attributed to a variety of causes. Too often, zones are plagued with the same problems – unstable electricity, lack of water, heavy bureaucracy, inefficient and corrupt customs – that hinder investment in the wider economy. In addition, broader competitiveness challenges, including policy instability, poor national governance, and low productivity often undermine the potential of zones.

- The traditional manufacturing-oriented processing zone (EPZ) is becoming increasingly anachronistic, despite the continued importance of global production networks. This is for three main reasons. First, by limiting activities to manufacturing only, EPZs restrict opportunities for investment and growth in the services sector, one of the most important opportunities for growth in middle income and even many low income countries. Second, the traditional EPZ tends to create an enclave that is separated from the national market, undermining its potential to create effective domestic linkages. Finally, the traditional EPZ model relies on unsustainable fiscal incentives to attract investment. As a result, there has been a gradual shift from traditional EPZs to special economic zones (SEZs), which normally cover larger land areas, offer greater flexibility for services and other non-manufacturing activities (including residential and tourism development), and include a greater mix of export and domestic-market focused activities.

**THE WORLD BANK GROUP AND SEZS**

- The World Bank Group has worked with client governments on export processing zones, free trade zones, and SEZs for decades. More than 40 SEZ related projects have been undertaken in the past ten years. This work has included Bank lending for on-site and off-site infrastructure, IFC investment, and technical assistance and knowledge products from various Bank units and the Investment Climate Department on SEZ-related policies, legal and regulatory frameworks, institutional design, and feasibility studies.

**OUR WORK ON SEZS**

- During 2009 and 2010, the World Bank's International Trade Department (PRMTR) has been leading a major global research study on SEZs – supported by a BNPP trust fund and in partnership with the SEZ team in the World Bank Group's Investment Climate Department – with a primary emphasis on the experience SEZ programs in Sub-Saharan Africa. The main question addressed in this study is: why have SEZs worked well as engines of growth in some countries but not in many Sub-Saharan African ones?
- Based on knowledge developed as part of this research, PRMTR is also supporting the World Bank Group's program looking at the potential role and impact of China's investment in African industrial zones on the development prospects for the region. Our portfolio of SEZ knowledge products in 2010 includes:
  I. A book summarizing the results of PRMTR's major research project: *Special Economic Zones in Africa – assessing performance and learning from global experience* (forthcoming);
  II. A set of *case studies of SEZ programs* in ten countries (Bangladesh, Dominican Republic, Ghana, Honduras, Kenya, Lesotho, Nigeria, Senegal, Tanzania, Vietnam);
  III. Results from *surveys of investors in SEZs* in the same ten countries as above;
  IV. A series of *notes covering topical issues in SEZs*, including: regional trade agreements and SEZs; WTO rules and SEZ fiscal incentives; gender aspects of SEZs; using SEZs as catalysts for economic reform; training and skills development in SEZs; etc.; and
  V. Notes related to *China's investment in African industrial zones*, including an overview of progress and challenges and a proposed framework for effective collaboration, as well as a note drawing lessons from China's experience in establishing a knowledge-sharing partnership for SEZs with Singapore in China's Suzhou Industrial Park.