

## SPECIAL ECONOMIC ZONES

Special Economic Zones (SEZs) have existed in various forms for nearly two millennia as a method of stimulating economic activity, encouraging investment and attracting workers.

Richard Thoman points out that the idea of special economic zones has “followed the routes of colonial and subsequent international shipping to all continents but Australia.”<sup>1</sup>

SEZs provide local and international businesses with incentives to invest in development and infrastructure through reductions in tax and regulation.

Tax benefits are the most common form of incentive and can take the form of a tax break or a tax holiday.

The closest experience Australia has had to developing an SEZ was in Darwin. While the Darwin Trade Development Zone failed primarily because of over-interference from government and incentives for prospective investors, SEZs can be designed to match Australia’s unique conditions.

Internationally, differing types of SEZs are common Australia is almost unique in the Asia Pacific region in not having any.

Prominent examples of SEZs in Asia include Shenzhen in China and Iskandar in Malaysia. However, SEZs are not the sole domain of developing countries. For many years, both the United States and the United Kingdom have used Enterprise Zones to encourage growth in depressed areas.

## DIFFERENT SPECIAL ECONOMIC ZONE MODELS

### SPECIAL ECONOMIC ZONES - GENERAL

Special Economic Zones are designated geographical areas governed by a single management body. They attempt to increase trade through attractive taxation levels and reduced regulation and customs duties. Many variations have developed within this broad framework. Encouraging fiscal, social and infrastructure development is generally the key aspiration.

### FREE TRADE ZONES

A Free Trade Zone is a tax-free area where goods can be landed and ‘value added’, through handling and manufacturing, and re-exported without the intervention of customs. These zones generally focus on labour intensive manufacturing goods, such as textiles and electrical equipment and often have reduced environmental and labour controls. The Colón Free Trade Zone located on the Panama Canal is one successful example. Due to its geographical location Colón acts as a major manufacturing hub for goods destined for Latin

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<sup>1</sup> Richard Thoman, Free Ports and Foreign Trade Zones, 1956, p2

America. A smaller alternative is a Bonded Warehouse. In both examples duties are only payable once goods move to domestic consumers.

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#### EXPORT PROCESSING ZONES

Generally seen in developing countries, EPZs are used to encourage commercial exports. They are similar to FTZs in that they normally encompass large land estates but they generally do not provide the same level of tax and regulatory benefits. By concentrating production in a specific industry, EPZs offer economies of scale and other practical advantages to investors.

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#### ENTERPRISE ZONES

Enterprise zones are an application of SEZ principles to urban development. Spurred by the decline of traditionally industrial towns in the United Kingdom and United States, enterprise zones seek to lower regulatory and taxation levels in urban or suburban settings. More recently Zones Franches Urbaines in France and Area Contracts in Italy have also been established. The common feature of these initiatives is the availability of tax subsidies; however, they can vary greatly in size. Supplementary incentives often include the creation of affordable housing, increasing public safety, and increasing job training in close proximity to the region.

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#### SINGLE FACTORIES

Single Factories are the only type of Special Economic Zone that is not confined geographically. Instead they are focused on the development of a particular factory or enterprise regardless of location. Single Factories are promoted in countries wishing to create a concentration of exporters in a specific industry. Single Factory models are used widely in Africa, and provide flexibility of location while offering the fiscal and trade-related benefits of zone programs.

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#### FREEPORTS

Freeports are expansive zones that specialise in human capital intensive goods and services and specialise in service related trade including call centres, travel, tourism and retail industries. Freeports are generally more integrated into the domestic economy. Both the Philippines and India have used these zones, converting large military bases into Freeports that function as specialised cities. More recently, Korea's 'International City' on the island of Cheju is a prominent example.

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#### SPECIALISED ZONES

Specialised Zones have also been established to promote highly technical products and specialised services. These zones are often focused on the production and promotion of science and technology parks, such as Dubai's Internet City, which focuses on the development of software and internet-based services. In Malaysia, the Labuan Offshore Financial Centre is another example.

### ISKANDAR DEVELOPMENT REGION

The Iskandar Development Region (IDR) is a Malaysian Special Economic Zone established in 2006. The zone covers 2,217 square kilometers and includes the Senai Airport and the ports of Tanjung Pelepas and Pasir Gudang. The IDR is administered by Iskandar Development Region Authority (IDRA), a Malaysian Federal Government statutory body.

Value-added and knowledge intensive industries are a key target of the IDR. Six service based sectors are targeted for exemptions:

- I. Creative industries
- II. Educational services
- III. Financial advisory and consulting services
- IV. Healthcare services
- V. Logistic services
- VI. Tourism related activities

Incentives provided:

- I. Exemption from Foreign Investment Committee rules
- II. Freedoms relating to foreign employment
- III. Exemption from corporate income tax for a period of 10 years from commencement of activities
- IV. Exemptions from withholding tax on royalty and technical fee payment to non-residents for a period of 10 years from commencement of activities
- V. Skilled foreign workers are exempt from tax on car purchases

Like Shenzhen, the IDR has a unique geographical location which makes it highly suited to rapid growth, located just 50 minutes drive from Singapore's Changi International Airport, and positioned on international sea lines of communication. Just as Shenzhen was heavily reliant on investment from Hong Kong, the IDR has been heavily reliant on investment from Singapore.

The Wall Street Journal reported that as Singapore runs out of land to expand, it is joining forces to develop IDR into Singapore's new hinterland, with space for multinational companies, industry and housing.

So far more than 3,500 Singaporean businesses have set up in Iskandar in the past six years. Over 70 per cent of businesses established have been small and medium sized enterprises.

### SHENZHEN SPECIAL ECONOMIC ZONE

China has a number of Special Economic Zones, but its best known is Shenzhen, established at the beginning of Deng Xiaoping's Reform and Opening Up policy in 1979. Since then the zone has expanded, and Shenzhen now covers nearly 2,000 square kilometres.

Firms operating within Shenzhen enjoyed substantial benefits compared to the surrounding areas:

- I. Company tax rate of 15 per cent, compared to the 30 per cent tax rate of private companies in the rest of China
- II. Corporate income tax holidays for agriculture, industry, and transportation
- III. Duty free exports and imports
- IV. Wages set by the market – free from the rigid Chinese centralised wage-setting system
- V. Reduce bureaucracy and red tape

Since its establishment Shenzhen has gone from a relatively small fishing village to a thriving metropolis. It has been China's fastest growing city for nearly three decades. Between 2001 and 2005 its economy grew by an average of 16.3 percent annually.

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#### UK ENTERPRISE ZONES

The UK's Enterprise Zones are generally located on vacant, unoccupied or deteriorating industrial land in depressed regional centres.

Tax concessions, reduced bureaucracy and public-sector infrastructure renewal are all used to encourage private investment, develop property and increase business activity.

The 2011-2012 Budget made provisions for 21 Special Enterprise Zones. These zones have been created on the understanding that "securing economic growth requires local business, the public sector and communities to be able to act decisively to increase prosperity."

Incentives include:

- I. Simplified planning rules
  - a. Local development orders allow development to be undertaken without planning permission from local authorities
  - b. Substantially reducing compliance costs and time delays
- II. Tax concessions
  - c. Business rates discount worth up to £275,000 per business over a five year period
  - d. Local council in total control of the rate levied on companies within the zone

A 2000 study of rural Special Enterprise Zones conducted by Jonathan Potter and Barry Moore found substantial positive results from Enterprise Zones – particularly in reducing regional disadvantage.

- I. One third of the businesses in the remote zones were influenced to invest by the incentives
- II. 33% of businesses were start ups
- III. Nearly two thirds of inward investors were in the manufacturing industry
- IV. Businesses established in zones were more likely than not to remain once incentives ended

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## PIRAEUS SPECIAL ECONOMIC ZONES

Greece is currently in talks with the European Commission to establish several Special Economic Zones in an attempt to attract investment and break five years of recession. Minister for Development Kostis Hatzidakis said “we think these special zones would boost the real economy by operating under a special regime to attract investment and increase exports.”<sup>2</sup>

China has backed the idea, suggesting the port of Piraeus as a possible site. Cosco, the state-owned shipping company, already operates a container terminal in the area and the Chinese government has pledged participation by Chinese companies in the project.

Burdensome bureaucratic processes have been a major hindrance to investment in Greece. A streamlined regulatory process is seen as a solution.

## AUSTRALIAN PRECEDENT

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### THE DARWIN TRADE DEVELOPMENT ZONE

The Trade Development Zone (TDZ) in Darwin was established in 1985 to develop a manufacturing centre on Asia’s doorstep so that the Northern Territory could become the ‘Regional Gateway’ to the extensive Asian market. The broad aim of the scheme was to expand the territory’s economic base and move from ‘low technology manufacturing’ to ‘medium to high technology industries.’

In order to achieve this, the zone offered a number of incentives:

- I. Exemption from the Northern Territory’s payroll tax and stamp duty
- II. One zone fee to replace a variety of other government charges and rates. This was a fee that was to “fall lightest in the early years of business establishment”
- III. Priority processing of business applications
- IV. Advisory services particularly customs, corporate and sales tax advice
- V. Facilities like conference centres and a customs agency all with centralised security
- VI. Bonded warehouse space
- VII. Financial, training, freight, relocation and energy cost assistance through the Northern Territory Development Corporation

While the TDZ was in operation for about 18 years, evidence suggests it was not successful in achieving what it set out to do. If the aim was to attract new Asian businesses and a more advanced manufacturing industry it failed dismally. By 1990, almost five years after its opening, only four companies and 300 staff called the TDZ home. Five years later the zone employed only 97 staff.

The Trade Development Zone was closed in 2003 and the area turned into the Darwin Business Park under the jurisdiction of the Land Development Corporation. The park contains almost no remnants of the TDZ incentive policies, but aims to provide an integration of services and facilities for industrial businesses.

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<sup>2</sup> Quoted in *Financial Times*, 28 August 2012

The most compelling explanation as to why Darwin's vision of becoming a hub for Asian industry failed is its small population.

Darwin's small and regulated workforce was in direct competition with its Asian neighbours in an industry within which it was not already a leader. A small workforce culminates in increased operating costs for businesses.

Mining and retail are particularly well established in northern Australia already. They contribute significantly to northern Australia economically and have the potential to further expand. A Northern Economic Zone should not attempt to introduce an unfamiliar industry into the region but set up tax and regulatory arrangements which encourage existing businesses and industries to grow and promote broad regional development.

## FACTORS AFFECTING SUCCESS AND FAILURE

World Bank research has concluded that the most common reasons SEZs are not successful include:

- I. Poor site locations, entailing heavy capital expenditures
- II. Uncompetitive policies – reliance on tax holidays, rigid performance requirements, poor labour policies and practices
- III. Poor zone development practices – inappropriately designed or over-designed facilities, inadequate maintenance and promotion practices
- IV. Cumbersome procedures and controls
- V. Inadequate administrative structures or too many bodies involved in zone administration
- VI. Weak coordination between private developers and governments in infrastructure provision<sup>3</sup>

A joint United Nations Economic and Social Commission for Asia and the Pacific and Korea Maritime Institute report concluded that "certain factors that greatly increase the likelihood of success for (a SEZ include) ... quality infrastructure, a supportive government, lighter regulation, a strong export focus, tax and customs exemptions and large storage and logistics capacities".<sup>4</sup>

The most successful SEZs specialise in specific products or industries, are located close to transportation outlets and are supported by efficient infrastructure. A close connection to global commerce is of significant importance. SEZs that are located close to a large community are also more successful as they are able to attract employees more easily. Similarly, the location of service industries with in or nearby substantially increases the profitability and economic efficiency of companies operating within an SEZ.

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<sup>3</sup> Foreign Investment Advisory Service, 2008, *Special Economic Zones: Performance, lessons learned, and implications for zone development*, p. 5

<sup>4</sup> United Nations Economic and Social Commission for the Asia Pacific and Korea Maritime Institute, 2005, *Free Trade Zone and Port Hinterland Development*, p. xi.

## POSSIBLE MODELS FOR AUSTRALIA

There are a wide variety of SEZ models that can be applied to Northern Australia. However, industry specific zones are more likely to have success.

A major Northern Special Economic Zone could take two very distinct routes, either driven by manufacturing or by services. Given Australia's highly educated population the latter is more likely to have success. The model pursued in Iskandar is hence more likely to be suited to Australia. However, the establishment of industry specific services is likely to achieve positive results.

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### MEDICAL SERVICES

The creation of a Specialised Zone concentrating on the provision of medical services would work in several areas across Northern Australia including: Northern Queensland, Darwin or North Western Australia. Providing tax and regulatory incentives to private investors would encourage the establishment of private medical services. High quality medical services are attractive to affluent citizens throughout Asia. Further, the establishment of such facilities would also be advantageous to local communities.

Medical service provision would also go hand in hand with the tourism sector, particularly in relation to less invasive treatments – Cairns is already established as a destination for fertility treatments.

Encouraging the development of medical services could be achieved through either Specialisation Zones on a Single Factory model.

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### NORTHERN CATTLE PROCESSING ZONE

Northern Australia is already a major exporter of live cattle, responsible for over 80% of Australia's total exports. However, the industry is facing increasing difficulties. The creation of a northern cattle-processing zone could be pivotal in maintaining the profitability of the industry. Encouraging the establishment of processing equipment relating to live export industry and an abattoir in close proximity to the port and other transport infrastructure would allow the industry to take advantage of the North's close proximity to the growing Asian population.

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### EDUCATION

Australia is already a major exporter of education. However, with a growing middle class, demand for Australian education facilities is only going to increase from Asian students. By encouraging the establishment of an education hub in the North, the region could become a major provider. This could be specialised universities, focusing on something such as Tropical Medicine, or with a broader spectrum of subjects.

Model	Description	Example	Australian Possibilities
<b>Special Economic Zone</b>	<ul style="list-style-type: none"> <li>• Low-tax, low-regulation geographical areas.</li> <li>• Designed to encourage investment and population growth.</li> <li>• Governed by a single management body.</li> <li>• Based around a competitive advantage or location.</li> <li>• Implemented to encourage economic, social or infrastructure development.</li> </ul>	<ul style="list-style-type: none"> <li>• Iskandar, Malaysia</li> <li>• Shenzhen, China</li> </ul>	<ul style="list-style-type: none"> <li>• Across North Australia</li> <li>• North Queensland</li> <li>• North Western Australia</li> <li>• Darwin</li> </ul>
<b>Free Trade Zone</b>	<ul style="list-style-type: none"> <li>• Expansive style of SEZ.</li> <li>• An FTZ is a geographically confined (generally fenced-in) tax free area.</li> <li>• Provides warehouse, storage, distribution facilities for trade and shipping.</li> <li>• Reduced regulatory environment, less stringent customs, few labour and environmental controls.</li> <li>• Generally located around major seaports, airports or frontier regions with geographical advantages.</li> </ul>	<ul style="list-style-type: none"> <li>• Colón, Panama</li> <li>• Copenhagen, Denmark</li> <li>• Gdańsk, Poland</li> <li>• Iquique, Chile</li> </ul>	<ul style="list-style-type: none"> <li>• Broome</li> <li>• Darwin</li> <li>• Townsville</li> </ul>
<b>Customs Bonded Warehouse</b>	<ul style="list-style-type: none"> <li>• A smaller alternative to a Free Trade Zone.</li> <li>• A warehouse or building in which goods may be stored, manipulated, or undergo manufacture without payment of duty.</li> <li>• Only once the goods move to consumers within the country are they subject to duties.</li> </ul>	<ul style="list-style-type: none"> <li>• United States</li> <li>• China</li> </ul>	<ul style="list-style-type: none"> <li>• Darwin</li> <li>• Broome</li> <li>• Port Hedland</li> </ul>



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**Export Processing Zone**

- Large land estates focused on foreign exports in key industries.
- Less prominent tax and regulatory incentives.
- Allow investors to take advantage of economies of scale provided by geographic concentration of production.
- Beneficial to host country as it does not provide tax incentives, but benefits from increased trade.

- Thailand
- Philippines
- Mauritius
- Bulgaria
- Slovenia
- Honduras
- Egypt
- Sri Lankan

- Darwin- cattle processing zone
- Port Hedland- mining related
- Dampier- mining related

**Enterprise Zones**

- Manufacturing and production benefits that overflow to local development efforts.
- Generally used to revitalise a depressed area.
- Tax incentives and financial assistance to encourage trade and spur organic localised development.
- Begins at an individual suburban level.

- United Kingdom
- United States
- France
- Italy

- Townsville (suburbs)
- Darwin (suburbs)
- Alice Springs
- Mt Isa

**Single Factory**

- A special type of SEZ that is not geographically restricted.
- Development of one particular factory or enterprise regardless of location.
- Used to encourage the establishment of exports in a specific industry.

- Mauritius
- Mexico

- Medical Facilities
  - Education Facilities
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**Freeport**

- Zones specialising in attracting human capital intensive services.
  - Generally very expansive, encompassing travel, tourism and retail sales.
  - Generally well integrated into wider domestic economy.
- India
  - Philippines
  - 'International city' Korea
- Cairns
  - Broome
  - Darwin

**Specialised Zone**

- Established to develop highly technical products and services, unique to a specific industry.
  - Examples include promotion of science and technology parks, petrochemical zones, warehousing sites and airport based economies.
- Dubai 'internet city'
  - Labuan Offshore Financial Centre, Malaysia.
- Medical Services
  - Financial Services
  - Education
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