Export Processing Zones and their relevance to Namibia

Robin Sherbourne

April 1993

NEPRU RESEARCH REPORT NO. 8
NEPRU produces:

- Books
- Research Reports
- Working Papers
- Briefing Papers
- Travel and Meeting Reports
- Occasional Papers

Please turn to the back pages for a list of publications.

All rights reserved. No part of this publication may be reproduced or transmitted in any form or by any means, including photocopying, recording and storage in a retrieval system, without the writing permission of the copyright holder except in accordance with the copyright legislation in force in the Republic of Namibia.

© Copyright 1993 by the Namibian Economic Policy Research Unit.

NEPRU res. rep. ISSN 1026-8231

First published in 1993 by the Namibian Economic Policy Research Unit, P.O. Box 40219 Ausspannplatz, Windhoek, Namibia
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACP</td>
<td>Africa Caribbean Pacific</td>
</tr>
<tr>
<td>ADB</td>
<td>African Development Bank</td>
</tr>
<tr>
<td>CMA</td>
<td>Common Monetary Area</td>
</tr>
<tr>
<td>DBSA</td>
<td>Development Bank of Southern Africa</td>
</tr>
<tr>
<td>EC</td>
<td>European Community</td>
</tr>
<tr>
<td>EMA</td>
<td>Export Marketing Assistance</td>
</tr>
<tr>
<td>EPU</td>
<td>Export Processing Unit</td>
</tr>
<tr>
<td>EPZ</td>
<td>Export Processing Zone</td>
</tr>
<tr>
<td>FAP</td>
<td>Financial Assistance Policy</td>
</tr>
<tr>
<td>GATT</td>
<td>General Agreement on Tariffs and Trade</td>
</tr>
<tr>
<td>GEIS</td>
<td>General Export Incentive Scheme</td>
</tr>
<tr>
<td>IDC</td>
<td>Industrial Development Corporation of South Africa</td>
</tr>
<tr>
<td>MFA</td>
<td>MultiFibre Arrangement</td>
</tr>
<tr>
<td>MNC</td>
<td>MultiNational Corporation</td>
</tr>
<tr>
<td>NFI</td>
<td>New Forms of Investment</td>
</tr>
<tr>
<td>NIC</td>
<td>Newly Industrialised Country</td>
</tr>
<tr>
<td>PWV</td>
<td>Pretoria-Witwatersrand Vereeniging</td>
</tr>
<tr>
<td>RICP</td>
<td>Regional Industrial Development Programme</td>
</tr>
<tr>
<td>SACU</td>
<td>Southern African Customs Union</td>
</tr>
<tr>
<td>UDOA</td>
<td>West African Customs Union</td>
</tr>
</tbody>
</table>
1. Introduction

1.1 There is currently much debate over whether an Export Processing Zone (EPZ) should be established in Namibia. The Government has decided that the EPZ concept is worth investigating as a policy option and has commissioned a study to be carried out as part of a broader investigation into options for trade policy reform financed by the African Development Bank (ADB). Government interest in EPZs has also manifested itself in the form of visits to Mauritius, Malaysia and Ireland, all of whose EPZs are commonly considered to have been extremely successful. Several parties in commerce, industry and the trade unions have also taken a keen interest in the idea of establishing an EPZ in Namibia. Furthermore, other countries in the region, notably South Africa and Mozambique, are seriously considering the concept, thereby adding to the urgency of the discussion in Namibia.

1.2 EPZs are usually physically separate industrial estates outside a nation's normal customs regime. The firms that operate within them enjoy duty free imports of inputs and equipment as well as more favourable rates of taxation and better infrastructure. In addition, EPZs are usually exempted from many industrial regulations applying elsewhere in the country. These benefits are given on condition that firms operating in the zone export their production. The EPZ enclave can therefore be viewed as an island of production unfettered by regulations and free from the price distortions imposed by import tariffs allowing EPZ firms to compete more effectively on world markets.

1.3 There are two ways of looking at EPZs. One sees firms operating outside the zones as being discriminated against and excluded from possible beneficial fiscal treatment. The other sees the EPZ concept as one that "levels the playing field" and allows firms to compete on equal terms with international competition. The logic of both views implies that an extension of EPZ treatment to all firms in the economy would be beneficial.

1.4 Although EPZs are found in countries of greatly differing income, they have come to be seen as a means by which lower income countries can rapidly transform their economies and increase industrial employment, enter world markets for manufactured goods, increase foreign exchange earnings and income, increase foreign direct investment and enhance training and skills acquisition within the economy as a whole. In short, the EPZ concept holds out the promise of achieving a number of common development objectives.

1.5 EPZs came about partly as a response to high wages and production costs firms faced in their home countries which, combined with declining communications and transport costs, eroded the competitiveness of manufacturers in industrial countries. Firms moved labour-intensive activities to low labour cost countries. This trend has brought about a shift in world sources of income and also allowed more small companies to operate abroad. It has also meant a change in the nature of foreign ventures and the type of activities undertaken.

1.6 This short paper attempts two things. It surveys the international literature on EPZs and tries to draw lessons from the experiences of other countries. It also briefly examines how these lessons could apply to the Namibian situation. The approach adopted involves posing a question on each area of concern to the EPZ concept. International experience is then assessed in an attempt to answer the question. Concrete examples are referred to in order to illustrate certain points and lessons for Namibia are drawn. The intention is to add to the debate on how the EPZ concept may effectively be applied in Namibia.
2. What is the international experience of EPZs?

2.1 Global experience with the EPZ concept has been extremely varied. Some widely publicised cases have been spectacularly successful whilst others have sunk without trace. Any study on comparative experience must also recognise that few detailed cost-benefit studies of EPZs have been carried out in spite of the fact that EPZs are probably among the most closely monitored public projects upon which great hopes are pinned. Strictly speaking, therefore, it is difficult to come to hard and fast conclusions about the success of any particular example. Instead, success can only be judged by approximate measures such as figures for direct employment and the number of factories operating in the zone. However, these indicators can sometimes be misleading and it is quite possible that a seemingly successful EPZ is in fact only a showcase heavily subsidised by the rest of the economy.

2.2 If attention is focused on developing countries as classified by the World Bank and only EPZs located on well-defined sites - "fenced in" EPZs - are compared, approximate measures suggest that, of the 60 existing zones around the world about which judgements can be made, at least 25 appear predominantly successful and 18 clearly unsuccessful with the rest falling somewhere in between. Almost all of the successful examples lie in Asia or in the Dominican Republic and Jamaica. Only one clear-cut success exists in the rest of the developing world, in Costa Rica. Average employment in the less successful zones is less than 1,000 people per zone compared to 10,500 in Asia and 6,000 in the Dominican Republic and Jamaica. Some zones with high levels of employment must be classed as unsuccessful because of high subsidies (Kandla in India) or because of exorbitant infrastructure costs (Balaoi in the Philippines). These figures exclude out and out failures such as the schemes in Ecuador, Western Samoa and Zaire, which never attracted any investors, and Nicaragua which lost them all. There appears to be some advantage in being an early starter. For late starters returns have often been negligible. Furthermore, the rapid proliferation of EPZs has meant that they have in effect become an internationally traded commodity, a trend which is likely to increase as more EPZs come into existence. Any new EPZ must be internationally competitive.

2.3 These rough comparisons exclude countries such as Mauritius and Mexico which are often cited as successful examples of EPZs. However, these are cases where EPZ-type incentives are not confined to well-defined locations and are therefore not strictly "zones". The World Bank(26) is very much in favour of countrywide fiscal treatment and export incentives wherever possible rather than confining these to an EPZ. In accordance with its free-trading and outward-oriented philosophy, the Bank sees blanket incentives as a way of allowing all firms in protected economies to benefit from access to international markets and competition. Consistent with this view, EPZs are seen purely as a transitional instrument for supporting the initial entry of previously highly protected countries into world markets in the context of broader trade policy reforms involving a shift towards more outward-oriented strategies. In other words, the World Bank sees EPZs as a possible first step towards greater liberalisation. Furthermore, it recommends that EPZs be privately run. Unfortunately, it is unclear to what extent these recommendations are influenced by ideological considerations.

3. How important are EPZs in world trade?

3.1 The four most common administrative instruments available to governments to provide free-trade status to manufactured exports are the in-bond, duty exemption and duty drawback systems and EPZs. Of these, EPZs are the least widely used. Global exports from EPZs in developing countries were 4 to 5 percent of their total manufactured exports of $258 billion in 1988 and about 80
percent of total EPZ exports came from only three advanced middle-income developing economies. However, these figures relate solely to licensed EPZs and therefore exclude examples such as Mauritius and Mexico.

3.2 The twelve main EPZ countries have increased their share in world manufacturing value added by ten times between 1973 and 1981 but EPZs accounted for less than 20 percent of manufacturing employment in these countries so performance cannot be put down to backward and forward linkages. These twelve EPZs are situated in the twelve most dynamic NICs and performance could have to do with the overall dynamism of these countries' economies.

4. What kind of firm is attracted to an EPZ?

4.1 Over the past couple of decades EPZs have contributed to a significant change in the size and type of activity of firms that can be classified as multinational corporations (MNCs). Whereas in the past, large corporations from the United States and Western Europe manufacturing relatively high technology products dominated the ranks of MNCs, the present trend is towards a greater number of smaller, lower-tech companies.

4.2 EPZ employment tends to be concentrated in a few labour-intensive industries, mostly garments, electronics and electrical goods assembly. The dominant characteristic of foreign firms operating in EPZs is their mobility and ability to migrate from one EPZ to another. There appears to be little quantitative information on this phenomenon but one example, the Bataan Zone in the Philippines is documented. Between 1979 and 1982 the total number of firms in the zone increased from 51 to 52. Table 1 shows the turnover during that period.

<table>
<thead>
<tr>
<th>Table 1: Turnover of EPZ firms in the Philippines.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Firms Entering</td>
</tr>
<tr>
<td>Firms Leaving</td>
</tr>
<tr>
<td>Total Number of Firms</td>
</tr>
</tbody>
</table>


4.3 It is not clear whether such a turnover is typical. One reason firms depart is the fixed-term nature of the fiscal regimes they enjoy. Once the tax holiday initially offered to attract a firm expires, the firm may decide to leave and start a new tax holiday elsewhere. Sometimes the threat to leave is sufficient to persuade governments to continue fiscal incentives indefinitely.

4.4 The aggregate production figure of an entire EPZ can also hide a high degree of fluctuation in the output of the individual firms within it. This is partly due to the nature of the activities EPZ firms are engaged in which are often subject to volatile consumer tastes. But it is also a result of the ability of the holding corporation to suddenly switch production to another factory elsewhere in response to changes in demand.
4.5 Although foreign firms and their joint ventures predominate in most EPZs, local firms are active in almost all EPZs and actually outnumber foreign firms in India and Indonesia. Most foreign investment in electronics comes from USA or Japan while in garments investors tend to come from Hong Kong, Taiwan and Korea.

4.6 A further aspect of the foreign ownership of many EPZ firms is that they often tend to buy from other firms of the same nationality. For instance, Japanese firms tend to buy from other Japanese firms. As a result, MNC intra-trade leads to fewer backward linkages.

4.7 In principle, joint venture companies should create a domestically-owned proportion of profits but nominal ownership often disguises the actual degree of foreign control.

4.8 Placing too much reliance on foreign firms which have little stake in long-term development is a high risk strategy for any country.

5. What is the relationship of an EPZ to the domestic economy?

5.1 Due to their enclave nature, EPZs are often quite separate from the host economy. However, at the same time it appears that successful EPZs depend greatly on the policy environment in the rest of the economy. Thus, a host country's monetary policy is crucial to the environment in which an EPZ operates and determines the exchange rate at which local inputs must be purchased, the interest rates at which local capital can be borrowed, the rate of increase of the prices at which local goods and services are bought, and foreign exchange controls, which tend not to apply to EPZs.

6. What markets do EPZs serve?

6.1 Generally speaking, firms operating in EPZs sell their products in the high income markets of the US and the European Community (EC). In fact, a large number of EPZs owe their existence to the desire by many firms operating in East Asia to circumvent import quotas to both the US and the EC. By relocating operations to countries whose quotas are not fulfilled firms can increase exports to their most important markets. This phenomenon has been especially important for producers wishing to export clothing into the EC. Mauritius is a particularly good example and exports are destined mainly to the EC and the US.

6.2 The market situation of EPZs in developing countries makes them highly susceptible to economic fluctuations and changes in tastes. Furthermore, the profitability of a particular EPZ may be highly dependent on international agreements concerning investments and exports as well as US preferences and Lomé. Thus, it is possible that a change in the Lomé Convention in 1995 could reduce the potential viability of a Namibian EPZ. There is also the additional point that, because of this dependence on quotas, additional output cannot be sold once the quota is filled.

6.3 The question of quotas for exports to the EC is not straightforward. In principle, as an ACP signatory of the Lomé Convention, Namibian products enjoy duty and quota free access to the EC. However, special rules apply at least for agricultural products and textiles. In the case of manufactured products, the situation is complicated by the Convention's rules of origin provisions which are specifically designed to prevent non-ACP countries benefiting from Lomé by simply routing exports to the EC through ACP countries with only a minimum of processing taking place
in the ACP state. These provisions prevent ACP states from gaining free access for goods undergoing assembly operations, goods involving more than 40 percent of non-originating material and even the making of shirts from cloth(7). Thus, it is not clear just how attractive Namibia's ACP status would be to a prospective EPZ investor.

7. Do EPZs create employment?

7.1 Global employment in fenced-in EPZ employment increased from around 220,000 in 1978 to 374,000 in 1986 and stood at around 530,000 in 1990 in developing countries(26). Presently 71 percent of developing world EPZ employment is in Asia, 21 percent in the Dominican Republic, 7 percent elsewhere in Latin America and the Caribbean and 1 percent in the rest of the developing world. The global figure of about 530,000 is a very small proportion of the total workforce in manufacturing in developing countries. Other estimates which take a broader definition of what constitutes an EPZ put employment at as many as 3.5 million(11). It is undoubtedly true that in some cases EPZs have produced employment opportunities and increased incomes. However, the cost of creating a job in an EPZ must be compared to the cost of creating a job elsewhere in the economy.

7.2 Taking the broader EPZ definition, the major EPZs in Africa in 1986 were, by employment, Mauritius (47 percent), Tunisia (30.5 percent) and Egypt (19 percent) with all others contributing only 3.5 percent of the total of 131,200 employees(16).

7.3 Perhaps the two most illustrative examples of EPZs in Africa are Mauritius and Senegal(5). Mauritius has been spectacularly successful whilst Senegal has been rather unsuccessful. The success of Mauritius, however, appears to be due to some exceptional circumstances which are probably not to be found elsewhere. Thus, a very high proportion of foreign equity capital came from Hong Kong whose interest derives in part from the presence of an active Chinese business community in Mauritius as well as the need for the Hong Kong textile and garment industry to avoid the quota restrictions on exports which is part of the MultiFibre Arrangement (MFA) on textile trading. In Mauritius, 60-90 percent of EPZ activity in terms of the number of firms and numbers employed has been in textiles. There has also been interest from French investors as a result of the francophone-speaking community in Mauritius. Unlike many other countries in Africa, Mauritius has not had to rely on so-called new forms of investment (NFI) type arrangements. Furthermore, firms have been able to raise considerable finance on the local market.

7.4 The success of the Mauritian type fiscal package alone is clearly not sufficient to attract investment as demonstrated by the case of Senegal where fiscal incentives were if anything even more generous than those of Mauritius. The zone was established in 1974 but by 1985 only seven firms were in operation, all of which were exporting to the West African Customs Union (UDOA). By 1990, an estimated 1,200 people were employed there.

7.5 This evidence suggests that successful EPZs require the presence of a very dynamic business community with links to overseas investors whose resources can be complemented by domestic funds. Furthermore, the underlying competitiveness of the host economy must be high in international terms. Fiscal incentives appear only to reinforce existing cost advantages rather than offset disadvantages. More importantly, Mauritian labour costs were 25 percent of those in Hong Kong and Singapore although productivity would also have to be compared to make a thorough assessment of comparative labour costs.
7.6 There is evidence that even the Mauritian example may not be as durable as all that. Exports rose only 4 percent in 1989 and not at all in 1990. Employment growth has stopped and absenteeism and pressures to increase real wages are eating away at the EPZ's competitiveness.

8. Are pay and conditions in EPZs worse than in the rest of the economy?

8.1 The literature surveyed for this study agreed that wages in EPZs are generally equal to or higher than those in comparable jobs in the surrounding economies. At the same time it appears that the extremely competitive environment in which EPZ firms operate prevents wages from increasing ahead of productivity. Conditions also tend to be better although in some zones there are considerable problems in terms of pressure to work overtime and machinery safety.

8.2 EPZ firms generally comply with minimum wage legislation. Their greater visibility and politically sensitive position make violations more difficult. Contrary to popular belief, EPZ workers are generally covered by national labour laws. However, in the Dominican Republic and Sri Lanka labour organizers are not allowed to enter EPZs. In Bangladesh, union activities were suspended and in Pakistan strikes are banned. In Korea the right to form unions is restricted. However, in Mauritius active unions exist and in Mexico unionisation is on the increase. Thus, whilst unions exist only in a few EPZs and are banned altogether in some, it does not appear that successful EPZs are necessarily those without unions.

8.3 The fact that wages in EPZs around the world do not appear to be lower than in their surrounding economies does not mean that this would necessarily be the case in Namibia where wage levels in the formal sector are reputed to be high. Because so little research has been done in this area it is difficult to come to a conclusion on the question of comparative labour costs.

9. How do EPZs affect women?

9.1 An interesting aspect of EPZs is the nature of the employment they create. According to the World Bank[25] women make up at least three-quarters of workers in most EPZs where they tend to hold semi-skilled jobs. Men generally fill the skilled and management posts. The age profile of the women is young, commonly between 16 and 25, and there is a high turnover as they leave within a few years of taking up their jobs to marry and have children. In many countries these young women would not have sought industrial jobs in the absence of an EPZ. EPZs have therefore often contributed to an increased participation rate of women in the industrial labour force and have provided relatively few jobs for unemployed male workers.

9.2 One study in Bataan[25] found that the average duration of employment was three years and that most workers were between seventeen and twenty-four with no previous factory experience. Those who had jobs prior to working in the zone were found to earn on average 35 percent more in the zone. Official data from the Philippines confirms that earnings are certainly no lower in the zone than those offered for similar work in the capital city. In fact real wages for skilled positions were higher.

9.3 Depending on how unemployment is measured, the introduction of an EPZ may not lead to a reduction of unemployment but may have beneficial effects on the social status and economic power of women. This consideration is important in Namibia where the most visible form of unemployment consists of young men waiting on street corners in the hope of being picked up
for casual work. It is unlikely that an EPZ will directly address their needs. However, given that one of Namibia’s development objectives is to raise the welfare of women, EPZ employment creation may result in important social benefits.

10. Do EPZs encourage foreign investment?

10.1 In many developing countries foreign capital is often desired in order to overcome insufficient domestic savings. EPZ industrialisation does not draw away the country’s own scarce capital resources unless EPZ firms are allowed to borrow on local markets. In those EPZs which have been successful foreign capital was undoubtedly an important contributing factor. However, often it has served to supplement local resources and in many EPZs local investors are significant.

10.2 In the case of Namibia where CMA membership allows for the free flow of capital across boundaries of member countries, the problem is not so much one of insufficient savings and a corresponding lack of investible funds as one of a lack of investment opportunities which compare favourably with those on offer elsewhere within the CMA. Namibia is presently a net exporter of capital. It appears therefore that the reason for establishing an EPZ in Namibia would not primarily be to attract foreign capital.

11. Do EPZs lead to increased foreign exchange earnings?

11.1 EPZs undoubtedly lead to foreign exchange earnings but on a smaller scale than might at first be expected. Because capital equipment and inputs are often imported from outside the host country and profits are allowed to be repatriated to the home country of foreign-owned firms, the only hard currency earnings from foreign sales of EPZ exports are those derived from conversions into local currency to pay for local expenses such as wages paid to local labour and the payments for local services, utilities, materials and other non-labour costs paid to suppliers in the host country. This calculation excludes taxation which is dealt with later. All revenue from taxes represents a net benefit to the host country as without the EPZ there would be no tax revenue.

11.2 In one comparative study of five EPZs[3] it was estimated that more than 50 percent of foreign exchange benefits were due to employment. However, foreign exchange earnings must also be set against foreign exchange expenditures required to build the EPZ in the first place which may be considerable for a small country with limited resources.

11.3 A further consideration must be taken into account which relates to the exchange rate which is used to convert the currency from the hard currency earnings to the local currency. The host country can impose an implicit tax upon EPZ firms by requiring that they convert the hard currency into local currency through the central bank at an overvalued official exchange rate. Such a situation could in principle come about when Namibia introduces its own currency and, at some stage in the future, devalues it from the rand. At present, however, it appears unlikely that Namibia would pursue a policy of significantly overvaluing its exchange rate. More probable is that the Namibian monetary authorities will maintain the Namibia dollar at a realistic rate because deviation from this policy would have important detrimental effects on the whole economy.

11.4 The same study mentioned above found that the profits of domestically-owned firms are only a minuscule proportion of the overall benefits from EPZs. In addition, transfer pricing helps reduce foreign exchange earnings from foreign-owned firms. MNCs will often set the prices at which one
of their EPZ plants supplies other subsidiaries with goods at artificially low levels so as to shift profits from one country to another and thereby minimize the payment of taxation in a particular host country. However, this is more a problem of MNCs in general rather than EPZs.

Value added in EPZs is commonly about 25 percent the value of exports but is considerably higher in Taiwan and Korea due to the nature of the output produced. Typically, half of value added is accounted for by labour costs and the rest by rent, utilities, transport, services and goods, payment to creditors and owners. One can therefore expect that the net foreign exchange earnings for a country from the exports from foreign-owned EPZ factories may be as low as 15-20 percent of the value of the exports, a figure which actually compares quite favourably with earnings from manufactures produced outside EPZs in developing countries. Interestingly, the Malaysian EPZ has a poor record in this respect and wages make up virtually all the narrow gap between exports and import costs.

12. DO EPZs lead to increased exports of manufactured goods?

12.1 Fenced-in EPZs lead to increased manufactured exports but, as already mentioned, they are only the fourth most important means of stimulating exports. Out of a total of $258 billion in 1988, most developing country manufactured exports (excluding Hong Kong and Singapore which are now classified as high income countries) came from firms enjoying free-trade status through duty exemption or duty drawback systems with in-bond third. About 80 percent of EPZ exports were from Malaysia, Taiwan or Korea. Over $2 billion came from the virtual free port of Macau alone. Thus it would appear that EPZs are only one option to increase manufactured exports. Exports per worker vary from about $5,500 to around $10,000. However, where foreign-owned electronics firms predominate this figure is well over $30,000.

13. What sort of industrialisation do EPZs encourage?

13.1 In a study of five countries, Taiwan, the Philippines, Sri Lanka, Ireland and Malaysia, it was found that EPZs did not enhance the capacity of nationals of host countries to undertake large-scale production and move towards deeper industrialisation. In Ireland, for example, simpler operations are carried out in the zone and Irish-owned manufacturing is still confined to light industry.

13.2 Furthermore, net exports - the difference between exports and import requirements - were only found to be growing in Ireland and Taiwan but not in the Philippines, Sri Lanka and Malaysia where exports are highly import dependent. Clearly the import content depends on the nature of production. Taiwan, for instance, remains dependent on imported capital goods from Japan. The Bataan EPZ in the Philippines brought in net foreign exchange of 85.5 million pesos in 1982 but cost 3,790 million pesos to set up. This compares badly with the labour-intensive Philippine handicraft industry which brought in four times as much without the same support. Table 2 compares the importance of imports in five EPZs and shows how seemingly successful EPZs are often very highly import dependent.
Table 2: Importance of imports in selected EPZs.

<table>
<thead>
<tr>
<th>Country</th>
<th>Imports as % of exports</th>
<th>Trade surplus as % of exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ireland (1981)</td>
<td>40.5</td>
<td>59.5</td>
</tr>
<tr>
<td>Taiwan (1985)</td>
<td>53.3</td>
<td>46.7</td>
</tr>
<tr>
<td>Malaysia (1979)</td>
<td>94.7</td>
<td>5.3</td>
</tr>
<tr>
<td>Philippines (1973-82)</td>
<td>77.3</td>
<td>22.7</td>
</tr>
<tr>
<td>Sri Lanka (1979-81)</td>
<td>79.0</td>
<td>21.0</td>
</tr>
</tbody>
</table>

Source: country studies, Essential Statistics 1985[3].

13.3 Perhaps surprisingly, an ADB study on regional integration[3] finds that Mauritius is characterised by the lowest relative development of intermediate and capital goods industries of all the countries of Southern Africa.

14. Do EPZs develop links to the host economy?

14.1 There appears to be general agreement that backward linkages from EPZs rarely develop. This is due to the nature of EPZ firms which typically import inputs from countries other than the host country. Because they must compete on world markets, firms operating in EPZs must be free to choose inputs of the best price and quality they can find. Often, firms outside the EPZ are not in a position to produce to these standards unless they too compete internationally and enjoy the same benefits as the EPZ firm. Thus, where backward linkages have developed these have come about as a result of extending EPZ treatment to firms outside EPZs and developing the capacity to produce competitive world-class indirect export items. In some countries firms supplying to EPZs enjoy the same incentives as the direct exporters themselves.

14.2 Some EPZs have been built up to process raw materials produced by the host country but this is not typical. In one study on Indonesian, Korean, Malaysian and the Philippine EPZs[23], it was found that no more than one-third of the total purchases of raw materials came from local sources.

14.3 Although in Indonesia local textiles did constitute a significant input, in Malaysia and the Philippines only small quantities of local raw materials were used. The reason for this appears to have been the low quality of local materials but the nature of EPZ production is obviously also important. Electronics assembly, as opposed to garment manufacture, requires almost exclusively imported inputs. However, the global nature of EPZ firms means that they have little interest in tying themselves down to one particular source of supply and thereby jeopardise their mobility.

14.4 Another study[3] found that in Ireland the backward linkages that have developed have been mainly in services as opposed to the case of Taiwan where significant manufacturing links have developed. Backward linkages tend to be stronger in textiles and footwear where 15-20 percent of total raw materials are from domestic sources compared to electronics which uses less than 1 percent of domestic raw materials.
14.5 The raw materials Namibia can offer include fish, meat, hides and karakul pelts, minerals and some agricultural products, all of which are unusual for EPZ manufacturing and do not lend themselves to the type of operations footloose East Asian firms have been so successful with. There is perhaps some potential in Namibia for producing inputs to EPZ companies but little in the areas of textiles and electronics.

14.6 Forward linkages with the host economy are ruled out almost by definition as EPZs typically have to export all their production.

15. Do EPZs lead to a transfer of skills and technology to the rest of the economy?

15.1 In more sophisticated industries such as electronics it does not appear that much direct technological transfer takes place from EPZ firms to non-EPZ firms. Indeed, electronics firms are often known to guard special information carefully - even from their own workers. In this situation, domestic firms are viewed as potential competitors. However, there is an important transfer of knowledge through the movement of people out of the EPZ, where they have learnt production and export skills "on the job", into the domestic economy. The transfer of skills is potentially an important benefit even if it does not easily lend itself to measurement. Another important but unquantifiable effect of an EPZ is its potential demonstration effect on the rest of an economy which may be considerable.

15.2 The clearest example of an EPZ having positive spin-offs for the host economy is Taiwan. Although its EPZs have never contributed more than 8 percent of total exports, they attracted the first developed-country foreign investment and contributed importantly to the development of technically demanding industries. The EPZs also contributed to the gradual liberalisation of the policy environment outside the zones which have over time converged to policy within them.

16. How important is the location of an EPZ?

16.1 Bad location has been a major reason for failure of EPZs around the world. Governments are often tempted to site EPZs in neglected regions where there is high unemployment. Namibia should take note of this and seek to avoid such mistakes.

16.2 Other sources of EPZ failures include factors outside the scope of the EPZ itself such as political instability and a generally unfavourable business climate, as well as poor management, inadequate promotion campaigns and poor physical infrastructure.

17. What is the experience with Export Processing Units?

17.1 Export Processing Units or EPUs are export-oriented firms that enjoy the fiscal benefits of EPZ firms without being confined to a particular location. Information on EPUs is hard to come by. However, it is interesting to read in the report by the Development Bank of Southern Africa (DBSA) of South Africa's experience with EPU-type incentives. Apparently customs legislation in South Africa made provision for the rebate of duty on imports used in the production of exports, a system which was introduced in 1979. Export producers had to apply to the South African Board of Trade and Industry for a permit which allowed them full rebate on specified goods used for
the manufacturing, processing or packaging of export goods. A number of shortcomings became apparent which included:

- a lack of awareness of the provision on the part of producers;
- a lack of flexibility as only specific items could be given exemption unless the permit was changed;
- the application procedure for permits was difficult as they had to be thoroughly assessed and the applicant's competitors had to be consulted; and
- it was designed to encourage domestic producers geared mainly for the domestic market to export more.

17.2 The system encountered administrative problems in dealing with applications and it was found impossible to police the system adequately to prevent abuse of this relaxation of normal customs requirements. Imports tended to leak onto the domestic market at low prices adversely affecting domestic producers. As a result it was decided to phase out the provision by mid-1992.

17.3 This experience does not appear to be particularly common. As mentioned earlier economy-wide export incentive schemes have been extremely successful. These include:

- **Duty Drawback System** - where firms are allowed to claim back payments on duties and indirect taxes on inputs based on documented evidence and on input-output relationships in export production. These cannot compensate for non-tariff import restrictions. Whether this would conform to SACU regulations would have to be investigated.

- **Duty Exemption System** - where firms are obliged to export products corresponding to their duty-free imports within a specified period of time. The export obligation is determined on the basis of physical input-output coefficients. Import restrictions are also waived.

- **Bonded Manufacturing Warehouse** - which generally apply to firms exporting all their production. Imported inputs are "bonded" and rapidly delivered to the exporting firm.

17.4 These schemes appear complicated and difficult to administer. In particular, the need to develop knowledge of realistic input-output coefficients is demanding. However, in an economy as small as Namibia's this may not be as unrealistic as it sounds. It would require good cooperation between the Government and the private sector as well as an in-depth knowledge of private sector companies by Government officials. The latter would be of immense benefit to the relationship between the Government and the private sector as it would probably require greater knowledge than presently exists. The fact that such schemes do work in many countries bears testament that they can be made to work for the benefit of a range of dispersed firms. It is undeniable however, that economy-wide export incentive schemes require good customs administration and possibly greater administrative costs.

17.5 For good results these schemes need to be easy for exporters to understand and their procedures must be automatic and transparent. If a system is allowed to acquire discretionary elements, delays, uncertain results, special favours and corruption can result. It is crucial that whatever system is introduced, the misuse of duty-free imports is prevented since this leads to revenue loss and prevents the development of a stable market for intermediate goods industries.
17.6 Namibia is now a full member of GATT and must therefore ensure that whatever scheme is put into operation complies with GATT rules on export subsidies which require no excessive exemptions or rebates over free-trade status[25].

18. What are the advantages of fenced-in EPZs?

18.1 The EPU concept has been mentioned and there is much debate on the relative merits of fenced-in or "closed" EPZs, and EPUs or "open" EPZs:

18.2 For closed EPZs the advantages are:
- they can be more effectively policed;
- they are more easily administered by a "one-stop" administrative centre;
- they ease the provision of a package of services and facilities;
- they increase the possibilities of creating agglomeration, economies of scale and positive clustering;
- as demarcated areas, they are easier to exclude from host country legislation; and
- their results are more visible.

However, their disadvantages are:
- existing domestic firms must undertake costly relocation if they are to enjoy the status of EPZ firms;
- they force industries to locate in specific sites which may not support the optimum exploitation of comparative cost advantages in a large spatial economy;
- by concentrating resources on specific "growth points" they encourage movements of people from areas which might have potential and therefore increase centralised decision-making in terms of where production should take place;
- closed sites do not make use of existing infrastructure; and
- the possibility of excluding the zone from host country legislation will be seen as anti-trade union.

18.3 For open EPZs the advantages are:
- no relocation of established firms is necessary;
- existing infrastructure can be used;
- comparative advantages may be fully exploited;
more backward linkages could in principle be created and therefore enhance export orientation in the general economy; and
- they would be seen in a less hostile way by the trade unions.

The disadvantages on the other hand are:
- they are inherently more difficult to control especially where they do not export 100 percent of their output;
- it is more difficult to provide "one-stop" administration; and
- they are less visible and perhaps more difficult to promote.

18.4 Clearly, Customs and Excise Departments generally favour the closed option which involves much less policing and less control. However, by demanding that they export 100 percent of their output, EPUs can be effectively policed. The experience in South Africa appears to suggest that leakage from other systems would be considerable although in many other countries such schemes have been made to work successfully. This should be investigated.

19. How are EPZs best owned and administered?

19.1 Nowadays there is often a tendency to assume that publicly-owned productive assets are generally not as successful as privately-owned ones. In the case of EPZs this is not correct. The success of EPZs depends on how they are run not on who owns them. All Asian EPZs are publicly owned and include some of the most successful zones in the world. It seems that their success can partly be attributed to the fact that they have been run on commercial lines.

19.2 Public EPZs have a disappointing record outside Asia with some exceptions in the Dominican Republic and Jamaica. EPZs in Latin America are increasingly privately owned and run, allowing them added flexibility in their behaviour towards investors. Private ownership is certainly encouraged by the World Bank which regards the results so far in Latin America as encouraging.

19.3 Fenced-in EPZs are strictly policed so that no duty-free goods destined for use in the EPZ can be smuggled into the domestic economy. Policing is certainly easier in the case of a fenced-in enclave.

19.4 EPZ firms sometimes rent buildings from the agency in charge of running the EPZ but often lease land and build their own.

19.5 The success of an EPZ depends crucially on phasing infrastructural development such that costs are kept within reasonable limits and investment in infrastructure takes place as the EPZ develops. It is advisable that the cost per job should bear some relationship to total per capita income and average wages. A ratio of 5:1 or 10:1 between total investment costs and the annual wage is typical. A higher ratio indicates overinvestment, poor occupancy, or low wages. The example of the Philippines shows the dangers of expanding infrastructural development too rapidly.

19.6 Total employment in zone administration is usually 4-7 percent of total industrial employment in the zone.
19.7 Whilst it is hard to overstate the importance of realistic exchange rates and macroeconomic stability for the success of an EPZ, there are other factors which contribute to success. The principal ones are:

- a clear foreign investment regime;
- restriction-free and duty-free access to imports;
- rapid low-cost customs clearance;
- completely liberalised foreign exchange rate regime;
- quick bureaucratic responses;
- minimal regulatory control; and
- extension of free-trade status to estate development.

20. Are EPZs environmentally harmful?

20.1 There appears to be no evidence to show that EPZs are any worse in their environmental consequences than other industrial operations.

21. Do EPZs help foster greater regional trade and interdependence?

21.1 EPZs by their very nature offer little as a means to achieve greater regional economic integration for Namibia in Southern Africa. If the Namibian EPZ were to follow the common example, it would be importing materials from outside the region and exporting final products to destinations in the EC or the US. There may be scope for using materials available in the region as inputs, for example with textiles, but this will probably be limited as more countries establish their own EPZs and start competing both for inputs, markets and finance. The Senegalese EPZ is exceptional in that its output is exported to other African countries in the UDOA.

21.2 EPZs currently operating in Sub-Saharan Africa include the oldest in Africa, Mauritius (1970), and those set up in the subsequent decade in Senegal, Liberia, Ghana, as well as Zaire (1981), Togo (1989), and Madagascar (1989) whilst those contemplating or in the process of establishing EPZs include Cameroon, Kenya, Mozambique and, perhaps most importantly from Namibia's point of view, South Africa. Six others are under study in Benin, Comoros, Malawi, Nigeria, Rwanda and Zimbabwe. These developments will undoubtedly increase competition among countries for investors and markets. The prospects for investment relate to how investors view the opportunities within the country and how these compare with those available in other countries.

21.3 It appears that up to six EPZs could be established in South Africa following recommendations by the Industrial Development Corporation (IDC) and DBSA. Likely sites include Cape Town, Durban, Richards Bay, Port Elizabeth, East London and Jan Smuts Airport. However, they are unlikely to be financed or managed by the South African Government and may already enjoy incentives under the General Export Incentive Scheme (GEIS), Export Marketing Assistance (EMA) or Regional Industrial Development Programme (RIDP) will probably be excluded. The concept of EPUs appears to have been rejected. What is clear is that Namibia's EPZ may have to compete on equal terms with those of South Africa, especially if South Africa gains accession to the Lomé
Convention. This is disturbing as Namibia enjoys few benefits over South Africa apart from political stability and Lomé access. Namibian labour productivity appears to be lower although this may not be the case for the kind of workers an EPZ would employ. The prospects of a dynamic South African EPZ may increase if access to Lomé for South African manufactured products is secured.

21.4 Mozambique appears to be going ahead with three EPZs at its main ports of Maputo, Beira and Nacala. Considerable hope is also being placed on the development of an EPZ in Mombasa, Kenya, which is receiving considerable support from the World Bank. Clearly, however, the greater the numbers of EPZs in Africa, the more competition there will be for foreign investment. It is not clear how many zones the continent could successfully accommodate. Competition for foreign investment is fierce and is likely to become more so with increasing numbers of EPZs. There are at present no EPZs in the Southern Africa region. The evidence suggests that if Namibia is to establish an EPZ, it should be done as quickly as possible to gain a head start over other countries in the region.

21.5 At present, the main export market for Namibian manufactured goods is South Africa. This is largely a result of Namibia’s historical ties with South Africa but in the post-independence era the links are maintained through membership of the Southern African Customs Union (SACU). Whilst it is probably the case that an EPZ would not in principle be ruled out by the provisions of the SACU Agreement, the access Namibia enjoys to Southern Africa’s largest and wealthiest market would not be available to the output of a Namibian EPZ without considerable tariffs being imposed on the exported goods.

21.6 One further complicating factor is that future investment in Namibia will depend on future trading relations in the Southern African region, including future tariff regimes and domestic and regional incentives as well as the future relationship between South Africa and the EC. At this stage it is not easy to see how events in the region will unfold and this uncertainty may lead investors to hold off until the dust has settled.

22. How important is the fiscal regime of an EPZ?

22.1 The level of incentives, including such provisions as tax holidays, appear to be of secondary importance in attracting foreign firms to EPZs. The literature analyzed is clear in linking EPZ success with good macroeconomic management, especially good monetary management. There appears to be a close correlation between realistic exchange rates, reasonably low inflation and macroeconomic stability on the one hand and export success on the other.

23. How widely do EPZ incentives differ around the world?

23.1 It has been mentioned above that there is no simple correlation between the success of an EPZ and the incentives on offer. Commonly EPZs around the world offer low corporate income-tax rates, unrestricted capital and profits repatriation, 100 percent exemption of duty for all imports and exports, 100 percent tax exemption on dividends, and unrestricted management of foreign currency. However, there are differences in the incentives on offer as is shown by the comparisons in the tables below.
Table 3: Comparison of export incentives in Africa and Middle East.

<table>
<thead>
<tr>
<th></th>
<th>Dubai</th>
<th>Egypt</th>
<th>Mauritius</th>
<th>Senegal</th>
<th>Turkey</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate income tax abatement</td>
<td>100% exemption for 15 years</td>
<td>100% exemption for 5-15 years</td>
<td>15% tax rate</td>
<td>100% exemption until 1999</td>
<td>100% exemption in perpetuity</td>
</tr>
<tr>
<td>Capital/ profits repatriation</td>
<td>unrestricted</td>
<td>unrestricted</td>
<td>unrestricted</td>
<td>unrestricted</td>
<td>unrestricted</td>
</tr>
<tr>
<td>Duty treatment for all imports and exports</td>
<td>100% exemption</td>
<td>100% exemption</td>
<td>100% exemption</td>
<td>100% exemption</td>
<td>100% exemption</td>
</tr>
<tr>
<td>Tax on dividends</td>
<td>100% exemption</td>
<td>100% exemption up to 5% of dividend value</td>
<td>100% exemption</td>
<td>100% exemption</td>
<td>100% exemption</td>
</tr>
<tr>
<td>Restrictions on foreign ownership</td>
<td>none</td>
<td>subject to control</td>
<td>none</td>
<td>none</td>
<td>subject to control</td>
</tr>
<tr>
<td>Sales to local market</td>
<td>unrestricted</td>
<td>unrestricted</td>
<td>10% of total output</td>
<td>20-25% of total output unless disruptive to local industry</td>
<td>n/a</td>
</tr>
<tr>
<td>Management of foreign currency</td>
<td>unrestricted</td>
<td>unrestricted</td>
<td>unrestricted</td>
<td>unrestricted</td>
<td>unrestricted</td>
</tr>
</tbody>
</table>
Table 4: Comparison of export incentives in Asia.

<table>
<thead>
<tr>
<th></th>
<th>Pakistan</th>
<th>Philippines</th>
<th>Singapore</th>
<th>Sri Lanka</th>
<th>Thailand</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate income tax</td>
<td>100% exemption until 2000</td>
<td>35% tax on corporate</td>
<td>33% tax on corporate</td>
<td>100% exemption for up to 100 years</td>
<td>100% exemption for 3-8 years, reductions therefor for 5 years; loss carry forward for 5 years</td>
</tr>
<tr>
<td>abatement</td>
<td></td>
<td>income</td>
<td>income</td>
<td>years</td>
<td></td>
</tr>
<tr>
<td>Capital/ profit</td>
<td>unrestricted for foreign</td>
<td>subject to the availability of foreign currency</td>
<td>unrestricted</td>
<td>unrestricted</td>
<td>unrestricted</td>
</tr>
<tr>
<td>repatriation</td>
<td>investment only</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Duty treatment for all</td>
<td>100% exemption</td>
<td>100% exemption</td>
<td>100% exemption for most items</td>
<td>100% exemption</td>
<td>100% exemption</td>
</tr>
<tr>
<td>imports, and exports</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax on dividends</td>
<td>100% exemption</td>
<td>35% tax</td>
<td>100% exemption</td>
<td>100% exemption</td>
<td>100% exemption for 5 years</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Restrictions on foreign</td>
<td>local investment limited up to 40% total investment</td>
<td>no foreign ownership of land permitted</td>
<td>none</td>
<td>none</td>
<td>subject to controls</td>
</tr>
<tr>
<td>ownership</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sales to local market</td>
<td>unrestricted</td>
<td>2% of total output</td>
<td>unrestricted</td>
<td>5-10% of total output; decided on a case-by-case basis</td>
<td>20% of total output</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Management of foreign</td>
<td>unrestricted</td>
<td>priority in allocation of foreign exchange</td>
<td>unrestricted</td>
<td>unrestricted</td>
<td>controlled during foreign exchange crisis</td>
</tr>
<tr>
<td>currency</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Table 5: Comparison of export incentives in Taiwan and Korea.

<table>
<thead>
<tr>
<th></th>
<th>Taiwan</th>
<th>South Korea</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate income tax abatement</td>
<td>100% exemption for 5 years exemption from other indirect taxes</td>
<td>exemption from indirect taxes acquisition property and other indirect taxes exemption from aliens personal income tax</td>
</tr>
<tr>
<td>Capital/profits repatriation</td>
<td>100% exemption on imports of raw materials, parts, machinery and all exports</td>
<td>100% exemption on imports of capital goods, raw materials, parts and semi-finished goods, and on all zone exports</td>
</tr>
<tr>
<td>Duty treatment for all imports and exports</td>
<td>unrestricted</td>
<td>unrestricted</td>
</tr>
<tr>
<td>Tax on dividends</td>
<td>20% tax</td>
<td>5 year tax holiday; 50% reduction for 3 years</td>
</tr>
<tr>
<td>Restrictions on foreign ownership</td>
<td>unrestricted</td>
<td>unrestricted</td>
</tr>
<tr>
<td>Salos to local market</td>
<td>2% of annual output</td>
<td>n/a</td>
</tr>
<tr>
<td>Management of foreign currency</td>
<td>unrestricted</td>
<td>controlled access to foreign exchange requiring authorization</td>
</tr>
</tbody>
</table>

Source: Data compiled by The Services Group (TSG)\(^{19}\).

23.2 Although, for reasons mentioned, above the fiscal regime offered by a Namibian EPZ would probably not be the principal attraction to foreign investors, it would have to be internationally competitive and offer incentives comparable to those listed in the tables. Namibia already has a Foreign Investment Act which lays out the framework within which foreign investors can operate in Namibia. However, it is unclear to what extent the Act conflicts with the foreign exchange regulations of the CMA to which Namibia will belong for at least another two years. This situation must be clarified as soon as possible if a clear and transparent investment regime is to be established\(^{19}\).

24. What tax incentives should be offered in a Namibian EPZ?

24.1 As mentioned above, business confidence in the general economy appears to be more important in attracting firms to EPZs than the tax incentives on offer. There is conflicting evidence on how important the levels of subsidies and fiscal incentives are in attracting investment. None of the literature surveyed found a correlation between the success of a zone and the incentives offered in spite of their often considerable cost to the host country. Given this, what levels of fiscal incentives would be internationally competitive?
24.2 Generous tax holidays of 3 to 10 years are often granted to firms in EPZs. However, by
threatening to move to another EPZ, firms can often prolong these periods. If a move is completed
the holiday begins again in another EPZ. In the Philippines, generous deductions are offered and
very little tax revenue has been raised.[25] Interestingly, some firms have declared losses for
over a decade while still producing and even expanding. Vertically integrated firms use transfer
pricing to relocate profits internationally in order to reduce their global tax burden, a phenomenon
which is extremely difficult to monitor. There is often no profit tax on EPZ firms.

24.3 On top of beneficial tax treatment and superior infrastructure, utilities are often subsidised. EPZs
tend to be heavy users of electricity and rates are never above industrial rates elsewhere in the
country.

24.4 Taxes raised from EPZ firms are a clear benefit for the domestic economy. Without the zone there
would be no taxes. Only in cases where local firms move into the EPZ or where firms come which
would have come anyway will there be lost tax revenue. Such cases are rare and few EPZ firms
would have invested in their countries of location if the EPZ had not been established. One further
consideration is that firms from some countries, such as the US, are allowed to credit taxes paid
abroad against taxes paid at home in which case tax holidays merely transfer revenue from the
treasury of the host country to that of the investor's home country.

24.5 A Namibian EPZ would probably have to compete with other incentive schemes in the region
which include the RIDP, the GEIS and the EMA in South Africa, as well as the Financial Assistance
Policy (FAP) in Botswana. Of these, only the GEIS is specifically aimed at increasing exports.

24.6 The GEIS was introduced in 1990 in order to offset the competitive disadvantages being
experienced by South African firms as a result of macroeconomic instability and the relatively high
domestic prices of input goods compared to international prices.[25] The GEIS is designed to
encourage greater domestic value adding and the export of fully manufactured products. The
incentives fall into four categories - for primary products, beneficiated primary products, material
intensive products and manufactured products - which receive cash assistance of 0 percent, 7.5
percent, 12.5 percent, and 19.5 percent of the value of exports respectively, which is also varied
according to a formula which takes into account inflation and exchange rate fluctuations. The GEIS
is not cheap, an estimated R1.5 billion being paid out in 1992.

24.7 A number of criticisms have been made of the GEIS, that it creates rent seeking opportunities,
that it has done little to encourage new exporters of manufactured goods, that it is unselective and
gives assistance to firms that do not need it, and that it is incompatible with GATT rules.
However, there is evidence that GEIS has helped improve the export performance of the higher
value-added products. South African manufactured exports (GEIS category 4) increased their
share in total exports from 5.0 percent in 1989 to 8.0 percent in 1991.

24.8 Table 8 shows the incentives for manufacturing operations in Southern Africa. They are not purely
export oriented but they do show the degree of regional competition for investment already in
existence. To a certain extent, a Namibian EPZ might be competing for investors with these
schemes and would therefore have to be competitive with them.
### Table 6: Incentives available in Southern Africa.

<table>
<thead>
<tr>
<th>Country</th>
<th>Incentives</th>
</tr>
</thead>
</table>
| Botswana | Capital grant of P1,000 per citizen job created ranging from 40% to 85% of fixed investment depending upon location under the Financial Assistance Policy (FAP) plus in Selibi-Phikwe area:  
- a "step down" reimbursement of 50% of the off-the-job and approved in-house training costs for the first five years;  
- a nominal rate of 15% corporate tax for the first 25 years of the life of the project and exemption from withholding tax on dividends from after-tax profits for the first ten years;  
- a "step down" grant up to a maximum of 8% of invoiced sales in the first two years of the project dropping to 2% in year 5. |
| Lesotho  | - a ten year tax holiday, extendable for up to 15 years;  
- an advanced factory shell programme which offers serviced industrial buildings for immediate lease;  
- access to foreign exchange and the repatriation of investment capital and earnings (profits and interest subject to 15% and 10% withholding tax respectively);  
- a government sponsored skills training grant which covers up to 75% of the wage bill during the training phase;  
- rapid processing of permits for foreign skilled labour required for the investment;  
- an export financing facility to assist in alleviating cash flow problems in manufacturing for export. |
| Swaziland | - five year tax holiday for a company engaged in a manufacturing concern new to the country;  
- double deductibility of approved training costs;  
- up to 50% initial depreciation allowance on plant and machinery in the first year or spread over several years;  
- generous depreciation allowances;  
- 10% local preferences on public tendering. |
### South Africa

- a two year establishment grant;
- a three year profit/output incentive period;
- approved foreign relocations will also qualify for the reimbursement of their relocation costs up to a maximum of R1 million in addition to the normal 5 year incentive scheme.

The maximum incentive consists of 70% of (100% of fixed assets + rent capitalised at 50% + 50% of current assets i.e., stocks and debtors) to a maximum of R15 million x 15% x 5 years.

The maximum amount is payable for the first two years of operation. In years 3 to 5, the output incentive is calculated according to the following formula:[

\[
(20\% \times PBT) + \left(1 + \frac{200\% \times ROA}{100}\right)
\]

where PBT is the profit before tax and ROA is the return on assets.

The incentive that a company would qualify for during years 3 to 5 is therefore 20% of profit before tax leveraged by 2% times the ROA, so devised in order to reward effective asset management as well as to introduce a bias towards employment creation because labour-intensive firms tend to record higher ROAs.

Within South Africa, the respective incentives will be offered as follows:

<table>
<thead>
<tr>
<th>Area</th>
<th>PWV and Durban core area</th>
<th>PWV and peripheral area + DFA + CP</th>
<th>Rest of South Africa</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>0%</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

DFA = Durban functional area
CP = Cape Peninsula

Note: 60% incentive = 20% effective tax rate
100% incentive = 32% effective tax rate

Source: "Regional Integration in Southern Africa", ADB.

#### 24.9

The most generous scheme is the RIDP in South Africa which was originally launched to attract industry to the "homeland" territories within South Africa. Although the old scheme has recently been abandoned, partly because of a prolonged desire to level the playing field and move to a more market-oriented basis for industrial development, it has been replaced by a broader incentives scheme offered in all areas outside the main PWV and Durban core areas of the country. Given the likely political situation in South Africa after a majority government comes to power, it is probable that some sort of regional incentives scheme will be maintained.

#### 24.10

Finally, it is interesting to note the variations in fiscal incentives available in the region. If the process of integration is to succeed, an attempt will have to be made to harmonise these measures and arrive at a regional incentives package consistent with the development objectives of the region as a whole.
25. Would an EPZ contribute to achieving Namibia's industrial development objectives?

25.1 In real terms the manufacturing sector (excluding fish processing) in Namibia contributed just over 4 percent to GDP in 1988 and 4.4 percent in 1991. In current prices manufactured products (again excluding fish products) worth R332.3 million were exported in 1991 which made up just over 10 percent of merchandise exports. Out of these exports R189 million were meat products and R143.3 "other". The ratio of exports to total output for the manufacturing sector is more difficult to establish. Namibian national accounts give value-added data for total sectoral output but do not give final output values. The only method available to derive this number was to use two input-output tables for the Namibian economy to calculate the figures. The first table was developed by Paul Hartmann in his work on the mining sector in Namibia and uses 1986 data and prices. If food processing is included, the percentage of final manufacturing output exported is nearly 27 percent. Excluding food it totals nearly 12 percent. The second table was developed by the Development Bank of Southern Africa using a short-cut technique. This second table uses 1965 data and prices and yields about 51 percent and over 13 percent respectively. The two results seem to agree on the degree to which Namibia's non-food processing industry is export oriented reflecting the very limited nature of production for export in this sector. If the results from the second table are to be believed it would appear that Namibia's food processing industry became more export oriented during the early 1980s. However, Namibia's small non-food processing manufacturing sector is not export oriented. It is possible that given the right incentives the sub-sector may be encouraged to export more.

25.2 Clearly there have been numerous cases of governments around the world latching on to the EPZ concept out of desperation without considering whether the concept is in fact the best way of utilizing scarce resources.

25.3 A fundamental question that must be clearly answered before establishing an EPZ in Namibia is whether Namibia wants to encourage increased manufactured exports from foreign firms or whether it wants to encourage exports from firms already established in Namibia. If the latter is more important because it is considered that local firms have a long-term stake in the future of the country and do not require as much in the way of tax incentives and subsidies for them to increase exports, the question really becomes: what type of incentive will be most effective in increasing exports? As mentioned above, a range of incentives is possible.

25.4 Clearly, an EPZ policy would benefit foreign firms or domestic firms willing to relocate. However, some of the firms in Table 7 might also increase export earnings given the right incentives. Furthermore, no expensive infrastructural construction on the part of the Government would be necessary to achieve this.
Table 7: Breakdown of the Namibian industrial sector by activity and employment in 1988.

<table>
<thead>
<tr>
<th>Activity</th>
<th>No. of companies</th>
<th>No. employed</th>
<th>percent of employment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food, Beverages and Tobacco</td>
<td>75</td>
<td>4687</td>
<td>51.1</td>
</tr>
<tr>
<td>Textile, wearing apparel and leather</td>
<td>21</td>
<td>389</td>
<td>4.2</td>
</tr>
<tr>
<td>Wood, wood products and furniture</td>
<td>42</td>
<td>669</td>
<td>7.3</td>
</tr>
<tr>
<td>Paper products, printing and publishing</td>
<td>13</td>
<td>454</td>
<td>4.9</td>
</tr>
<tr>
<td>Chemical products</td>
<td>11</td>
<td>323</td>
<td>3.6</td>
</tr>
<tr>
<td>Non-metal mineral products</td>
<td>19</td>
<td>1094</td>
<td>11.9</td>
</tr>
<tr>
<td>Metal products</td>
<td>33</td>
<td>1130</td>
<td>12.3</td>
</tr>
<tr>
<td>Repair services</td>
<td>25</td>
<td>293</td>
<td>3.2</td>
</tr>
<tr>
<td>Other</td>
<td>20</td>
<td>131</td>
<td>1.4</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>259</strong></td>
<td><strong>9176</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>

Source: Manufacturing Survey 1988[5].

25.5 Namibia's White Paper on Industrial Development[13] states the Government's objectives for the manufacturing sector as being:

a) To increase manufacturing value added by stimulating productivity, increased exports and, where efficient, import substitution.

b) To diversify and integrate the economy through the accelerated growth of the industrial sector and the creation of better links between its sub-sectors.

c) To generate productive employment opportunities and increased income opportunities for Namibians, especially disadvantaged groups such as women.

d) To improve the geographical distribution of industry in relation to the location of raw materials, markets, population and employment demand.

25.6 It is doubtful whether an EPZ would help deepen Namibia's shallow industrial sector. In fact, given the experience of other countries with EPZs, it is difficult to see how the objectives of import substitution, diversifying and integrating the economy and improving the geographical distribution of industry could be realised. An orthodox EPZ geared to 100 percent export will clearly play no part in achieving the Government's stated aim of encouraging import substitution. If EPZ development is to be focused mainly on foreign investors, will it contribute to the Namibianisation of industry which is also an objective stated in the White Paper? Firms attracted to EPZs want as few strings as possible attached to their presence. Encouraging them to train Namibians will not be easy. On the other hand, an EPZ may well increase productivity, exports (but possibly not exports to a lesser extent) and generate productive employment, benefits whose importance cannot be overstated. The question is only, benefits at what cost?
25.7 More specifically the Government will have to take decisions on a number of important questions which relate to the establishment of an EPZ in Namibia.

- The first relates to the recently adopted Labour Code whose provisions may well deter prospective investors. Should the Labour Code, in particular the provisions concerning working hours, overtime and the handling of industrial disputes, apply to the EPZ? Experience in many EPZs is that overtime is practically compulsory. Furthermore, it would be easy for an EPZ firm to threaten to leave if a dispute was not settled to its advantage.

- Will foreign investors in a Namibian EPZ be eligible for Certificates of Status Investment as laid out in the Foreign Investment Act of 1990? Furthermore, how will the EPZ’s foreign currency provisions square with the rules of the CMA, in particular regulations concerning foreign currency accounts and financial rand arrangements?

- If the Government is to take a leading role in establishing an EPZ, will it be located in previously underdeveloped regions? Experience shows that location has been a prime source of failure and that sites should not be chosen purely for purposes of regional development. If this is recognised, will the EPZ be developed instead of other previously neglected areas which the White Paper promises to develop? What is the opportunity cost associated with developing already well-developed areas?

- In the White Paper the Government promises to base utility prices on their economic cost. Will this mean that utilities to the EPZ will not be subsidised?

- Will the forthcoming industrial incentives package apply to firms operating in the EPZ?

26. Conclusion

26.1 For an already open trading economy like Namibia’s the need for an EPZ as a first step towards greater liberalisation appears to be less important than in many other highly-protected economies. Namibia’s situation does not compare with countries which have used EPZs as a first step in liberalising highly-protected economies. SACU tariffs are not especially high by international standards and Namibian industry has had to compete with larger and more established South African enterprises.

26.2 There are two basic questions that must be addressed when considering the desirability of an EPZ in Namibia:

- would an EPZ attract foreign firms to locate in Namibia which otherwise would not have come and would these firms contribute to the development of the country?

- would existing Namibian firms benefit from the establishment of an EPZ?

26.3 The evidence appears to show that the direct benefits of an EPZ are generally not as great as might at first be expected. The type of firms attracted, their input and market requirements, the nature of the employment created, the foreign exchange earned, as well as the prospects for greater regional development mean that the gains are quite limited. Furthermore, membership of regional organisations such as the CMA and SACU may limit the freedom to establish an EPZ in Namibia although the fact that EPZs are being studied in South Africa suggests this may not be a constraint.
Namibia's general policy environment and infrastructure could be a considerable attraction for investors provided administration of the zone was efficient. However, given the nature of EPZ operations it is difficult to see what else Namibia would have to offer. If this is the case, the real question then becomes whether an EPZ could be made to benefit Namibia's existing manufacturing exporters. As has so often been stated, the manufacturing industry that does exist in Namibia has grown up in the face of stiff competition from larger and more established South African firms. Namibian manufactured products are of high quality and could well be made internationally competitive if imported inputs could be bought at world prices which SACU membership presently disallows. The food processing manufacturing sector already exports a large proportion of its output and, although it has little experience exporting to destinations other than South Africa, this looks set to change as Namibia emerges from its pre-independence isolation. The challenge is then how to encourage existing Namibian industries to export more. The contribution an EPZ could make to this would be limited unless Namibian manufacturers were willing to relocate. A more general export incentive scheme of the types mentioned above would then be more appropriate and possibly cheaper.
REFERENCES


18. Sunday Times of South Africa Business Section 19 July 1992, "Export Zone Go-Ahead is on Way".

19. The Services Group, data presented to the Ministry of Trade and Industry.


