

CHAPTER V PATTERN OF SEZ

5.1 SEZ Concept

(1) General Concept of SEZ

Special Economic Zone (SEZ) originally and literally means any specific zone or area, designated by the authority, where the different economic principles, taxation systems, FDI treatment and other institutional procedures are being applied for promotion of foreign trades, Foreign Direct Investment (FDI), exports and inflow of up-to-date technologies, and consequently increase in employment and development of national economies.

What may often cause confusion in understanding the concept of SEZ is that the word “Special Economic Zone (SEZ)” has been used in two different ways. At the beginning of the 1980s, the People’s Republic of China (PRC) decided to introduce the scheme of “Economic Special Zone” (as in Chinese order), which was applied to four major cities, namely Shenzhen, Shantou, Xiamen, and Zhuhai in her coastal area of Guangdong Province. The word “SEZ” had, ever since then, begun to be used meaning this specific type of Chinese SEZ or similar types. In this Study, the word “SEZ” is used in the meaning first described in this section and does not specifically indicate or mean only a Chinese type of SEZ.

(2) General Objectives of SEZ

Although the objectives of SEZ slightly vary from time, country and case to another, the SEZ concept itself intends to attract, with preferential treatment and incentives, and utilize FDI to achieve its objectives. Such SEZ objectives can be summarized as follows:

- (i) To increase export, particularly non-traditional products export
- (ii) To generate foreign exchange earnings
- (iii) To promote inflow of up-to-date technologies, skills and expertise and transference of them to own nationals
- (iv) To increase employment and to upgrade standards of living
- (v) To strategically develop specific regions
- (vi) To promote strategic industries
- (vii) To raise the level of country’s industries in general
- (viii) To use SEZ as a trigger to activate national economies as a whole

(3) Methods to Operate SEZ and Expected Gains from SEZ

In order to attract FDI, host countries of SEZ, most of which have cheap and abundant work forces, provide FDI with the following advantages and/or incentives to promote investments in the sealed or designated areas, located at strategic points and with good market access.

- Fiscal incentives such as tax holidays, tax-and duty-free imports and exports, reduction of corporate and personal income tax
- Non-fiscal incentives such as the approval of immigration of foreign personnel, preferential visa treatment, on-site customs inspection, flexible employment conditions, freer control of foreign exchange, etc.
- Well-arranged infrastructure and facilities made ready by the government

In return, the government expects to attract investors so that it may collect lease rents, management fees and various charges, promote exports, generate foreign exchange, create and increase employment and upgrade the skill and technologies of workers and improve the national economy. In the region where SEZ locates, there will be more demands for local goods and services from investors and workers in SEZ, which may benefit the local economy.

5.2 Types of SEZ by Function

Types of SEZ can be classified into the following six categories:

- (i) Free Transit Zones (TZ)
- (ii) Free Ports (Free Zones/Entrepot Trade Zones)
- (iii) Free Trade Zones (FTZ)
- (iv) Export Processing Zones (EPZ)
- (v) Economic Special Zones (ESZ)
- (vi) Import Processing Zones (IPZ)

Categories (i) to (v) above are popular in developing countries. They have been developed with the major objectives to stimulate industrialization, commodity flow, increase in employment and foreign exchange earnings, introduction of up-to-date technologies.

Among these categories, Export Processing Zone (EPZ) is the most popular form. According to a report titled “Labor and social issues relating to export processing zones” published by International Labor Office in 1998, EPZ is defined as

“industrial zone with special incentives to attract foreign investment in which imported materials undergo some degree of processing before being exported again”.

Import Processing Zones (IPZ) in category (vi), on the other hand, have mostly been set up in the industrialized countries. IPZ originally aimed to promote general imports, but its objectives have been shifted to assemble parts and/or components imported mainly from developing countries into finished goods in the zones in order to quickly respond to the end-users’ orders in different forms. This so-called Quick Response System (QRS) has become more and more vital for manufacturers of personal computers, some electronics equipment or fashionable apparel, as customers’ needs are widely diversifying. IPZ usually locate close to the major airports, seaports or transportation junctions.

Characteristics of these SEZ are briefly explained in Table 5.1 on the following pages.

Table 5.1 Types of SEZ

	Location	Function	Purposes/Target	Incentives	Required Facilities/Conditions	Implemented country
Transit Zones (Free Transit Zones)	Boarder area (mostly coastal area)	Relaying the imported commodities from a landed country to a neighboring country, which imports commodities.	Gaining commercial profits through loading/unloading, warehousing and logistics services	Import duties shall be exempted for re-export. Duties shall be levied only for domestic sales.	Bonded warehouses, Loading/unloading facilities, Transport system	
Free Ports (Free Zones/ Entrepot Trade Zones)	A whole or a part of trading port area designated by the government: in general, sea ports but sometimes airports.	Re-shipment, trans-shipment, processing, conversion, assembling, exhibition etc. of foreign commodities, which go through the port.	Gaining commercial profits through loading / unloading, warehousing, processing, trade and exhibition, etc.	No or minimum duties levied on the passing goods. No or minimum government control over the foreign vessels. Possession /leasing of warehouses/factories is admitted.	Loading/ unloading facilities, bonded warehouses, manufacturing or processing factories, exhibiting facilities, etc. Distribution, banking and telecom. facilities are very vital.	Hong Kong Singapore
Free Trade Zones (FTZ)	A whole or a part of areas designated by the government as a free marketing place at any location near by trading or gate areas, sometimes at boarder area.	Marketing the domestic or imported goods for export or re-export.	Gaining commercial profits through free trading or exports.	No import duties levied on the imported goods for re-export. Exemption of local taxes	Exhibition facilities, market place, banking services, etc.	India
Export Processing Zones (EPZ)	Any location conveniently connected with major trading ports (sea or air) by the roads or sea transportation.	Manufacturing and/or processing the export-oriented goods by utilizing mostly the foreign capitals and technologies or sometimes combining those with the domestic capitals and products.	Exports promotion of processed or manufactured goods. Job creation. Inflow of foreign capital. Introduction of advanced foreign technologies.	Exemption of import duties for the materials, parts or component. Exemption of export duties, local taxes. Lower rate or exemption of corporate tax and free dividend remittance. Approval of higher share of foreign capitals (up to 100%), etc. Refund of VAT for indirect export	Access infrastructure to major trading ports. Satisfactory port facilities. Complete warehousing including bonded warehouse. Sufficient and reliable supply of utilities in the Zones. One-stop administrative services.	Taiwan (EPZ), Korea (FEZ), Singapore, Ireland, Thailand (EPZ), Malaysia (FZ, LMW*), Indonesia (EPTE, BZ**), The Philippines (EPZ), Vietnam (EPZ), India (EPZ), Sri Lanka (EPZ) LMW: Licensed Manufacturing Warehouses BZ: Bonded Zones

	Location	Function	Purposes/Target	Incentives	Required Facilities/Conditions	Implemented country
Economic Special Zones (ESZ)	Relatively large area like one whole city or an island, mainly located at coastal area and separated from other areas	Country inlet of foreign investment and the new technologies. A trigger for the reform of domestic economy on the market mechanism and a keystone to unify with international economy. Drawing-in the foreign market into the country.	Overall regional economic development and diffusion of the experiences of economic reform to other area. Introduction of foreign investment and acquisition of advanced technologies.	Approval of foreign investment in various businesses such as manufacturing, commerce, housing, tourism, public infrastructure. No import duties on capital goods and consumers goods used in SEZ. Reduced corporate tax. Grace period of corporate tax for the manufacturing or export industries.	Aggregated investment of FDI, public investment and local private Investment. Geographical conditions such as the accessibility to developed nations, trade centers or large markets are very vital. Reliable infrastructures, enough and relatively cheap manpower. Attraction for tourists.	China The Philippines
Import Processing Zone (IPZ)	Located close to the major airports, seaports or transportation junctions	Originally to promote general imports but recently shift to assemble parts and/or components imported from developing countries into finished goods in different forms	To respond quickly to the end-users' orders in different forms. In other words, to realize QR System (Quick Response System) in assembling and logistics	Not applicable	Warehouses and assembling factories	Mostly in developed countries

5.3 SEZ in Historical Perspective

(1) Variations

The history of SEZ dates back to the 13th century in Spain when King Alfonso X granted certain commercial privileges to the city of Cadiz. Singapore and Hong Kong had been Free Ports for a long time under the colonial regimes. It was only in the 1970s when SEZ concept, especially EPZ, was widely adopted and materialized in many countries.

EPZ was introduced worldwide for export promotion and it was set by the initiative of host countries. These countries could attract FDI by offering non-fiscal and fiscal incentives, abundant and cheap labor and lands, as well as certain levels of infrastructure in the zones. The current numbers of SEZ set up in the world, most of which are EPZs, are summarized below.

Table 5.2 Distribution of EPZs by Region, 1997

Region	Number of EPZ	Key countries
North America	320	U.S.A. 213, Mexico 107
Central America	4	Honduras 15, Costa Rica 9
Caribbean	51	Dominican Republic 35
South America	41	Colombia 11, Brazil 8
Europe	81	Bulgaria 8, Slovenia 8
Middle East	39	Turkey 11, Jordan 7
Asia	225	China 124, Philippines 35, Indonesia 26
Africa	47	Kenya 14, Egypt 6
Pacific	2	Australia 1, Fiji 1
Total	845	

Source: World Economic Processing Zone Authority

These numbers do not include some private EPZs. For examples, there are many EPZs that have been developed and operated by the private sector in the Philippines. Total number of such private EPZs is reported to be more than 130.

Contrary, in today's world, the international communications and logistics became much easier and faster and more Multi-National Enterprise (MNE) are operating worldwide, seeking new and changing conditions that require more integrated functions of SEZ. The old type of SEZ, which in many cases were the enclave-type and of single function, is losing its significance. Some MNEs even tend to avoid locating at the enclave zones in order not to bind

themselves by tight regulations of the zones operation and to freely seek more suitable locations for their operation.

The requirements that MNEs are currently seeking for in SEZ are summarized as follows:

- (i) Quicker response
- (ii) Shorter lead time
- (iii) Greater flexibility in production
- (iv) Lower cost
- (v) More suitable skill

(2) Evolution of SEZ

Responding to the consumers' diversified requirement, MNEs or even SMEs are getting more demanding for much more flexible, quicker, and freer manufacturing and export operation.

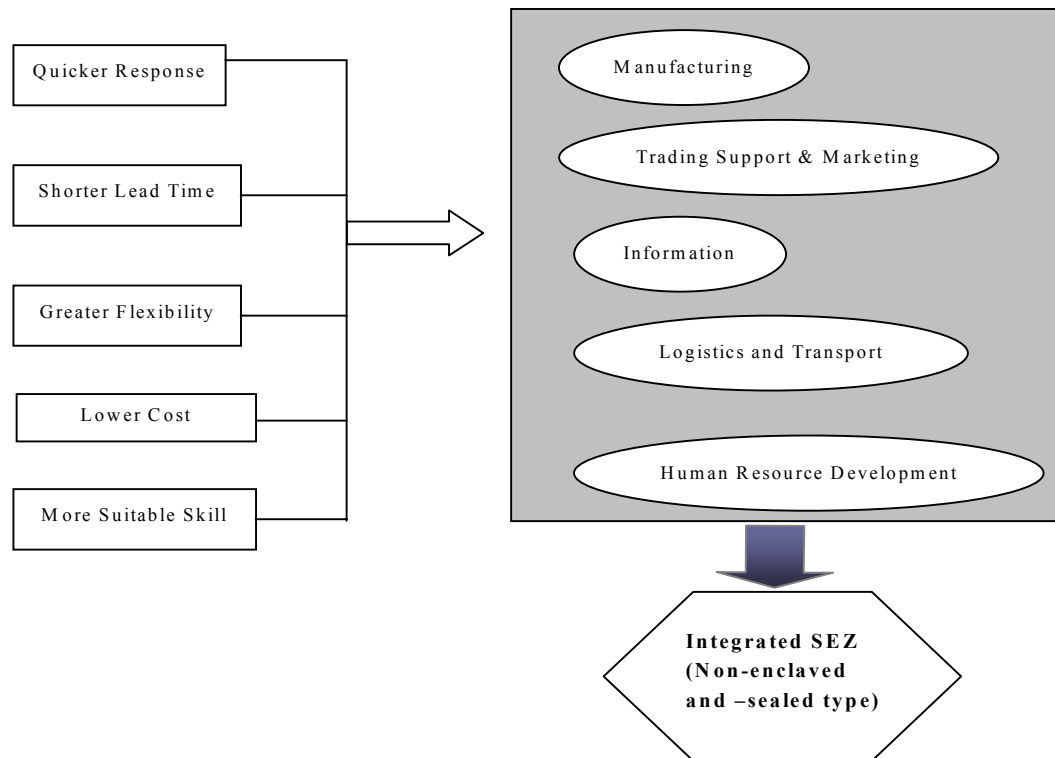


Figure 5.1 Evolution of SEZ

It is therefore likely that the enclaved and sealed-type zones will - where mere manufacturing or processing of products or parts are carried out in an isolated

place with no significant supporting facilities for trade in or around- fade away. Investors will move to more integrated zone concept where they can make use of all the necessary facilities, starting from manufacturing and processing to trading, logistics, marketing services, and even recreational needs.

5.4 SEZ in Asia

(1) General Situation

Among various types of SEZ, Asian countries traditionally put emphasis on developing EPZ due to their urgent needs for creating more employment, generating foreign exchanges, and upgrading technology level.

Taiwan, the Republic of Korea, and Singapore are among the successful examples in attaining all these purposes. Thailand, Malaysia, Indonesia, and the Philippines succeeded in realizing these partly, as they succeeded to attract quite a number of FDI. They, however, are still struggling to establish marketing and trade functions of their own initiatives for generating more value added and also to create closer linkage between FDI and local enterprises for absorbing higher technologies and/or expertise.

To this end, China seems to have succeeded in attaining all the goals by introducing the different approach from EPZ, called Economic Special Zone.

Comparing to other Asian countries, Vietnam adopted EPZ policy late and it seems to have had difficulties in developing EPZ. Trying to improve the situation, they modified Foreign Investment Law in July 2000 but it may take some more time for them to overcome the weak demand from FDI by regaining their confidence.

In order to derive some lessons of Asian countries, the cases of China, Thailand, Vietnam and the Philippines are reviewed below.

(2) ESZ (Economic Special Zones) in China

Chinese ESZ is often cited as a successful example of SEZ though it is different from SEZ in other countries. The most notable difference is that the entire cities or provinces were declared as ESZ in the Chinese case. These SEZ are not merely industrial estates but contain such community functions as residential areas, commercial areas, tourism and recreational facilities, transportation, education and health related facilities. In this case, the investors are entitled to utilize the existing urban facilities, which usually provide much wider supporting functions with the manufacturing firms and export supporting firms. They are also entitled to secure closer contact with

local firms so that both foreign investors and local enterprises benefit from interactive co-operation in manufacturing and export supporting activities.

The autonomy of ESZ authority has been secured and it became possible to provide flexible measures to attract FDI. By intermingling with local communities, FDI could acquire more confident profile about their investment not only in the manufacturing sector but also in such other fields as real estate, tourism, commerce, and infrastructure. Recent tendency of FDI in China shows that their investment in capital-intensive industries has apparently been increasing, while light industries are still the major absorber of FDI.

Despite the moderate fiscal incentives, as well as vague, inconsistent, and fragile legal system, Chinese ESZ seems to have been gaining success. The fundamental reasons are attributable to the progressive opening of the Chinese economy, realization of various supporting industries, fast learning ability of Chinese people, sufficient supply of skilled workers and high-tech engineers. All of them are important for modern manufacturing industries because multi-national manufacturers require quicker response, shorter lead-time and greater flexibility in manufacturing operation. The major reasons for success of Chinese SEZ are summarized below. (Detail explanation of Chinese ESZ is presented in Appendix 2.)

Reasons for Success of Chinese ESZ

- Adoption of integrated concept of SEZ
- Town or province-wise development concept
- Autonomous operation of SEZ
- Opening of Chinese economy
- Hong Kong's function as an inflow entrance for FDIs
- Existence of fast-learning and skilled workers
- Supply of higher grade engineers
- Relatively cheaper labors
- Strong commercial functions
- Locations and transport infrastructure

(3) EPZ in Thailand

Thailand is another successful country, having over 20-year experience in developing EPZ. One of the reasons for their success is that they managed to couple import-substitution policies with export-promotion policies by attracting the light industries in its early stage. Due to less competitive

situation of textiles at that time, Thailand could start with up-stream and middle-stream process which requires heavy investment. By attracting foreign textile industries, Thailand could establish its reputation as a FDI friendly country. The other reason for its success was its open and amicable attitudes toward FDI.

Industrial Estate Authority of Thailand (IEAT), a state enterprise attached to the Ministry of Industry, has been in charge of developing industrial estates of two different categories, namely General Industrial Zone (GIZ) and Export Processing Zone (EPZ). They claim that, as of year 2000, two kinds of industrial estate house 1,500 manufacturing plants with a total investment of 1 trillion bahts and generate over 400,000 jobs nationwide. IEAT develops and manages the industrial estates or sometimes jointly manages the industrial estates developed by private developers. The export value in EPZs rose from 47 billion bahts in 1994 to 205 billion bahts in 1999.

Following its initial success to attract FDI in labor-intensive industries, it has long been struggling to upgrade its FDI to quality investment. By heavily concentrating on metalworking, electronics and electric industries, it looks like gaining the status as regional supplier and exporter of metal-related products, automobile, electronics and electric products and parts.

The Thai EPZ concept, which has been successful so far, will have to be transformed according to its reform plans to match the MNEs requirements. To meet MNE's requirement, it may have to realize smoother customs clearance procedures, promote the export supporting functions such as IT, commercial activities and reliable financial facilities and secure supplying more sophisticated human resources.

Since 1996, the Thai Government introduced the new concept of EPZ where export-related trade and services have been added to EPZ functions. Another trial, in line with the transformation of EPZ, was the establishment of Free Trade Zones in its coastal areas. Although it was cancelled for some reason, the concept was similar to the Philippine's Subic Bay Special Economic and Free Trade Zone and Clark Special Economic Zone. (Detailed explanation on Thai EPZ is presented in Appendix 2.)

Major Reasons for Success of Thai SEZ and Future Issue

- Appropriate timing of establishing SEZ (Less competition)
- FDI friendly policies
- Consistency and flexibility in policies and society
- Necessity for changing SEZ to more integrated form
- Necessity for sufficient supply of more appropriate human resources

(4) EPZ in Vietnam

Vietnam was late in adopting the concept of EPZ. Only in 1991, after they adopted the so-called “Doi Moi” policy, they decided to open up the country for FDI. The initial approach was cautious and the foreign investment law was rather conservative in order to protect their local enterprises and national interest. For instance, they required unanimous principles for important resolutions in the board of directors of joint ventures, regardless of their capital shares or the compulsory hiring of local contractors for factory construction. The customs offices were rather notorious for FDI, licensing was selective, and the approval procedures took a long time.

The first EPZ in Ho Chi Min City, called Tan Thuan, was developed by Taiwanese capital and the Taiwanese concept of EPZ was introduced. It mainly targeted for promotion of SMEs. Coupled with inadequate infrastructure, and mismatch in policies (while promoting SMEs, US\$1 million minimum capital and 100% export obligation was imposed), the Tan Thuan EPZ could produce only a limited effect on FDI promotion. Because of its future potential, many investors were interested in Vietnam as export manufacturing bases and domestic marketplace. According to the information prepared by the Ministry of Planning and Investment of Vietnam in October 2000, the foreign investment of US\$35.8 billion, mainly from Singapore, Taiwan, Japan, the Republic of Korea, and Hong Kong, was registered between 1988 and 1999, but the materialization ratio has been rather low.

After 10 years since introducing EPZ, the export value of FDI in Vietnam has increased by 55.8% from US\$786 million in 1996 to US\$2.5 billion in 1999 but the enthusiasm of foreign investors seems to have already faded away. The other problem is that the export value of domestic enterprises rose only by 15.55% in the same period from US\$6.4 billion in 1996 to US\$8.9 billion in 1999. The technology and expertise transfer have not been successful as expected. Vietnam has been forced to reconsider EPZ policies. For instance, the Foreign Investment Law was amended in July 2000. A Chinese style SEZ

called Economic Zones (EZ) was introduced from 1996 in Mong Cai and 8 other places along the border areas, which put more emphasis on logistics, trade and tourism. They are also examining to adopt other successful concepts in their SEZ policy. The concept adopted in the New East Street Economic Zone of Shanghai and the Subic Bay Special Economic and Free Port Zone of the Philippines may be applied to develop Chu Lai Open Economic Zone in Vietnam. (Detail explanation on Vietnamese SEZ is shown in Appendix 2.)

Constraints of Vietnamese SEZ

- Conservative Foreign Investment Law
- Insufficient examination of SEZ policy target (mismatching between the target and regulations of SEZ policies)
- Attitudes of protectionism (national interest first)
- Inflexible treatment towards FDI
- Hard competition among Asian SEZ

(5) SEZ in the Philippines

The Philippines is also one of the succeeding countries in SEZ policies. The SEZ in the Philippines is called “Ecozone” which is considered to be a separate customs territory. The Ecozone enterprises, which have to export more than 70% of their production in case of foreign investors and more than 50% in case of domestic investors, are granted special preferential incentives that are applied only for Ecozone. While EPZ is designated to provide the manufacturing base for the purpose of export promotion, Ecozone aims to encourage commercial and other service activities, as well as manufacturing sectors, for export promotion.

Its concept was introduced in 1995 by enacting the Special Economic Zone Act (SEZ Act) and the operating authority called “the Philippine Economic Zone Authority (PEZA)” was established under this SEZ Act. Then existing 4 public-owned EPZs in Bataan, Baguio, Cebu and Cavite, which had been operated by Export Processing Zone Authority, and 12 other private-owned EPZs were transferred to under the management of PEZA. PEZA’s new policy for developing Ecozone was that it would not develop any more public-owned Ecozone but promote private-owned ones.

There are as many Ecozones as 135, consisting of the said 4 public-owned and 131 private-owned Ecozones nowadays. Among them, 44 private and 4 public-owned zones already have investors and some 67 private-owned Ecozones are waiting for the authorization by the president of the Republic.

According to the Web site of PEZA, the investment made in the Ecozones between 1995 and 1999 was counted as much as Philippine Peso (hereinafter “PHP”) 530.1 billion (approximately US\$12 billion at the present exchange rate), of which PHP227 billion were by the locators and PHP303 billion by the developers. The 45.7% of the investment made by the locators came from Japan, 15.4% from the USA, 14.6% from the Philippines, 6.6% from U.K., and 6.0% from Singapore. More than half of these investments came from the electronics parts and products sector, 16.3% from electrical machinery, 9.9% from basic metal products, and 6.8% from transport and car parts. Exporting US\$15.8 billion-worth of manufactured goods, which is equal to approximately half of the value of all manufactured goods exported from the Philippines, Ecozone provides more than 600,000 jobs nowadays.

At the same time, the Philippine government has been putting more emphasis on developing freer and more variety of SEZ to attract more FDI. This policy was adopted to attract development of the ex-naval base of Subic and ex-air force base of Clark. Likewise, Bases Conversion and Development Act of 1992 designated the Wallace Air Station, Camp John Hay (Baguio City) and other three ex-military bases as SEZ. (Details and other features of SEZ in the Philippines are presented in Appendix 2.)

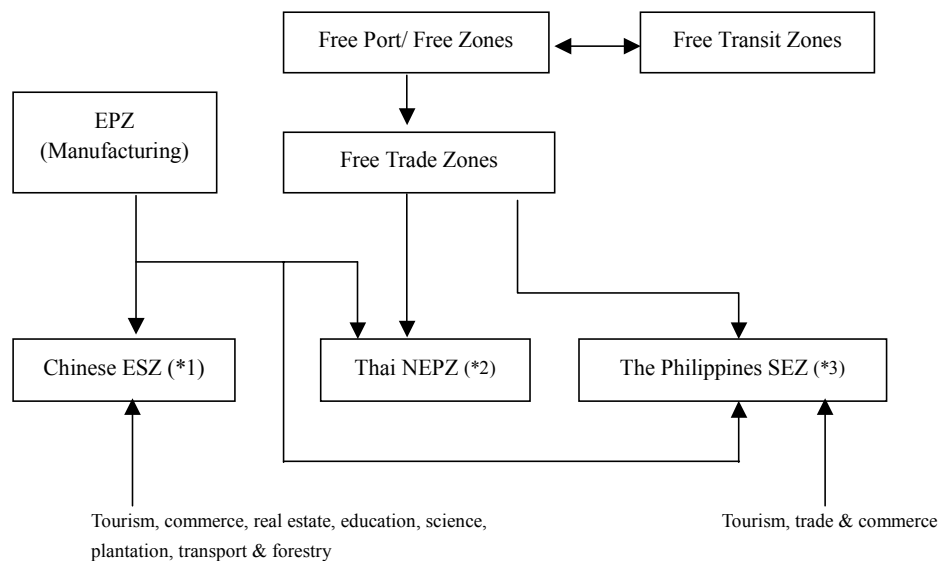
(6) Prospect of SEZ in Asia

As reviewed above, the scheme and formula of Asian SEZ have been changing since its earlier stage. It started as a Free Port or Free Transit Zone in Hong Kong and Singapore to provide the base to re-shipment for trade. It also served as re-export base for neighboring countries.

In the 1960s, Taiwan, Singapore, and South Korea introduced the concept of EPZ for promoting their exports. At the beginning, American, Japanese and some of European companies invested in EPZ in these countries, responding to the government requests for promotion of the import-substitution industries. As foreign capitals increased their production and exports in EPZ in these countries, the local enterprises outside of EPZ started production of similar products by using technologies learnt in EPZ. Coincidentally, those countries were famous for their hard working attitudes and learning abilities.

Referring to their success and experiences, such other countries as Thailand, Malaysia, the Philippines, Indonesia, and Vietnam introduced similar concept of EPZ. China also adopted EPZ but it enlarged the concept and integrated different functions in one scheme. Such a multi-functional SEZ was welcomed by MNEs who were urged to respond to the diversifying

customers' needs under fierce competition in pricing. By utilizing multi-functional SEZ, they intensified the integrated export operation and realized quicker response to the market. This tendency appears to continue and become a main stream of Asian SEZ. The Philippines has been successful in setting up similar concept SEZ in former U.S. military bases in rather less developed areas. A schematic concept of this transition of Asian SEZ is illustrated below.



- *1 Chinese ESZ: For export promotion, urbanization, trial for Market Economy by utilizing FDI.
- *2 Thai NEPZ: For promoting exports. Limited in manufacturing and export related services.
- *3 The Philippines SEZ: Subic and Clark. For promoting exports and direct inflow of foreign currencies, encouraging local economy, regional development

Figure 5.2 Transition of Asia SEZ

In recent years, it has become apparent that various type of SEZ has to be combined and integrated to form a more efficient and effective concept of SEZ. This is not only because many Asian countries begun to feel a limitation of SEZ under WTO, but also because the consumers' requirements have been diversified as information flows so quickly by development of the telecommunications system. The important issue to be addressed in examining the schemes and functions of SEZ is not only to consider the scheme, functions and roles, type by type, but also to think about how to combine and integrate them into an effective and feasible scheme.

5.5 Lessons Learnt from Asian Experiences

(1) Vital Conditions for Attracting FDI

A success in promoting SEZ relies not only on investment incentives that SEZ will be equipped, but also on many other factors that foreign investors may think vital. Before examining conceivable functions of the planned SEZ in Savannakhet, it is worthwhile to know what are vital factors for foreign investors from the experiences of other Asian SEZ. Some of factors vital for FDI are summarized as follows:

FDI Requirement for SEZ

- Existence of basic law
- Conformity of laws and regulations with the aim of encouraging economy and promoting exports
- Consistency of such governmental policies, especially the FDI policies
- Political and social stability (national credibility) and transparency of the social and economic systems
- Freedom in economic activities and authority's assurance for it
- Investment incentives
- Natural resources and industrial infrastructure
- Manufacturing and relevant cost
- Accessibility to major markets and domestic market size
- Human resources availability, cost and quality (learning ability, attitude towards work, quality consciousness, skill or technological background, etc.) of work forces, technicians and engineers
- New Factors: Quicker response, Shorter lead-time and Greater flexibility in production

(2) Success Factors Learnt from Asian Experience

Major factors that lead SEZ operations in China, Thailand, and the Philippines are summarized below.

Factors for Successful SEZ Operation Learnt from Asian Experience

- Definite selection of policy target
- FDI friendly policies
- Consistency and flexibility in FDI policies
- Social and political stability
- Adoption of integrated functions of SEZ concept
- Area, town or province-wise development concept
- Autonomous operation of SEZ
- Opening of national economy (liberalization of domestic market. Less protection of domestic firms)

- Appropriate and sufficient investment incentives
- Assurance of freer use of foreign exchange
- Existence of an inflow entrance for FDI (e.g., Hong Kong for China)
- Supply of fast-learning and skilled workers and higher grade engineers
- Relatively cheaper labors
- Strong commercial functions
- Locations suitable for logistics with sufficient transport infrastructure
- Readiness and appropriate infrastructure

(3) Comparison of Investment Incentives

As examined above, there are many vital factors for success in SEZ establishment. Some of them may be attributable to natural conditions (e.g., geographical conditions), which are difficult to change. However, as long as policies are concerned, there are ways to overcome unfavorable conditions. One of the major factors for FDI attraction and SEZ policies is the investment incentive offered to SEZ enterprises. The incentive schemes vary from one country to another. A comparison of investment incentives in some of the Asian countries is shown in the following pages.

(4) Critical Points to be learnt for Development of SEZ

Singapore's EPZ and China's ESZ may be a few examples to have succeeded in building the linkages between the EPZ firms and the domestic firms problems. Singapore pinpointed the target industries and provided the preferential incentives with such industries, of both foreign and domestic, as electronics and petrochemical-related industries in the past and information technologies and financial industries in recent years. China introduced the concept of multi-functional SEZ with no clear boundary between the premises of EPZ enterprises and local community, and developed one town and province as a whole to upgrade every aspect of regional economy. In the case of the Philippines, Subic and Clark seem to be on the same track in, though in a limited extent and scale. The problems Subic and Clark have is that, although the inside facilities for logistics are well equipped, the location of SEZ itself is not ideal for logistics industry and also that the fenced area of SEZ provokes some obstacles for close forward and backward linkages with local enterprises and industries. These lessons should be taken into account in planning the SEZ in Lao PDR.

Table 5.3 Comparison of Investment Incentives of Asian SEZ

	Chinese ESZ	Thai EPZ	The Philippine Ecozone	Vietnam EPZ
Tax Holiday	2 years (1 year for service industry)	Exemption of payment of income tax for a period granted by BOI	Income tax holiday of 4 to a maximum 8 years for non-pioneer and pioneer projects respectively	4 years tax holiday for manufacturing industries 2 years tax holidays for service industries
Corporate Tax	Reduction to 15% (7.5% for 3years after tax holiday, 2 years for service industry)	50% reduction of corporate tax for 5 years after the expiry date of tax holiday and the first profitable year Exemption from computation of taxable income on royalties and dividend	A special tax rate of 5% of gross income in lieu of all national and local taxes after the income tax holiday Exemption from all national and local taxes, in lieu of which a final tax of 5% of gross income must be paid (Subic) Tax credit for import substitution Tax credit on domestic capital equipment, breeding stocks and genetic materials Additional deduction for incremental labor expenses and training expenses	Reduction to 10% for manufacturing industries (normal: 25%) Reduction to 15% for service industries Refund of corporate tax of 15% for 3 years for re-investment
Other Tax	Business Tax -Exemption on exporting goods -Exemption on imported manufacturing facilities, materials, parts or transport measures -Reduction to half of a normal rate on mineral ores, tobacco or liquor -No incentive given to commercial/transport/ service industries Reduction or exemption of inhabitant's tax Exemption of remittance tax Withholding tax at a flat rate of 10% on dividend, interest, rent, license royalty	No surcharge, excise tax and VAT on machinery, parts, components, bi-products and raw materials for EPZ enterprises	Exemption from VAT, excise tax, valuables taxes and franchise taxes Exemption of wharf dues, export tax, import fees No exchange control Ecozone developers/operators shall pay real property tax	Reduction of remittance tax to 5% Other taxes and fees payable according to the current regulations
Import Duty	Exemption on the goods necessary for manufacturing and construction in ESZ	Exemption or reduction to one-half of import duty on machinery Maximum 10% reduction of import duty on raw materials Export promotion incentives -No import duty on raw materials -No import duty on the items for re-export.	Tax- and duty-free importation of capital equipment, raw materials, spare parts, supplies, breeding stocks and genetic materials	Exemption of import duties on machinery, parts, components, moulds and materials for these, raw materials

	Chinese ESZ	Thai EPZ	The Philippine Ecozone	Vietnam EPZ
Export Duty	Exemption of export goods of ESZ enterprises	Export promotion incentives -No export duty on the items produced or assembled by the promoted enterprises	Exempted	
Land Leasing	30-50 years (3 years exemption and half a rate for succeeding 3 years for hi-tech) Pre-determined land rent, to be reconsidered in every 3 years	Approval of foreign ownership of land	From 25 years but easy to extend	Duration of land lease shall conform with the duration of operation (less than 50 years) as specified in investment license.
Domestic Sale for outside on SEZ	Payment of unpaid duties on imported materials	Payment of surcharge, export duty, business tax and other	Up to 30% of income may come from domestic market	Exchange of goods between EPZ enterprise and domestic enterprises shall be considered as export-import activities
Foreign personnel	Hiring foreign personnel beyond the regulation	Only in case Thai nationals are not available, possible to hire	Permanent resident status for foreign investors and immediate family Employment of foreign nationals	Recruit and employ foreigners only for jobs, which require a level of technical and management expertise that Vietnamese citizen can not satisfy.
Other Privileges	Further incentives for investment into certain location Guarantee on remittance of foreign currencies	Approval of loss carry-over Deduction of 25% of initial cost from net profit at any time within 10 years Deduction of 5% of the increased income over the previous year from income	Exemption from SGS inspection Unrestricted use of consigned equipment Remittance of earnings without prior approval from the Philippine Central Bank. Right to freely engage in any business, trade, manufacturing, financial or service activity, and to import and export freely all types of goods into and out of SBF, subject to certain laws and regulations (Subic)	Approval of 100% foreign capital Approval of foreign bank operation in EPZ

5.6 Perspectives of SEZ in Lao PDR

(1) Direction of SEZ Development in Lao PDR

As reviewed before in previous sections, SEZ in Lao PDR should be directed as follows:

Direction of SEZ Development in Lao PDR

- Realization of a market economy within SEZ
- Utilization of FDI to supplement the lack of capital, technologies and expertise
- Industry development and creation of new jobs
- Promotion of technology transfer
- Human resource development

(2) Major Constraints of Lao PDR for establishment of SEZ

Lao PDR has some difficulties in promoting FDI and developing SEZ. They are partly due to geographical reason and partly due to current conditions of the economy. Before formulating development strategies for SEZ, Lao difficulties are to be clearly noted. These difficulties include the following:

Constraints of Lao PDR for SEZ

- Vague government attitude and policies towards FDI
- Non-transparent economic and regulative system
- Lack of adequate legal systems
- Common and mediocre investment incentives
- Lack of government capital to install sufficient infrastructures required in SEZ
- Immature accumulation of private capital to form joint ventures with foreign investors
- Local industries at the infant stage
- Small scattered population
- Under developed human resources

(3) Possible Countermeasures for SEZ development in Lao PDR

In spite of these difficulties, there are possible measures to tackle with the weaknesses, constrains and vulnerability, and to realize SEZ that will bring about favorable effects on Lao PDR. These measures will include the following:

Possible Countermeasures for Lao Constraints

- Legislation of a solid basic law for establishing SEZ, amending the foreign investment law and other relevant laws and regulations
- Firm government commitment on the consistency of SEZ policies
- Introduction of transparent operating system of SEZ
- Utilization of foreign private sectors for developing any sector in SEZ
- Introduction of an adequate foreign currency regime into SEZ
- Provision of full range of investment incentives to SEZ enterprises
- Utilization of foreign engineers and workers
- Promotion of the educational systems (including vocational training) with incentives given to foreign private investor
- Provision of comfortable living environment to attract foreigners
- Upgrading Internet and telecommunications systems in SEZ

(4) Basic Strategy of SEZ Development in Lao PDR

1) Principal issue

The first and most important issue to be addressed is that the SEZ scheme can work merely under the principle of the market-oriented economy that is the economy “of”, “by”, and “for” the consumers. In introducing SEZ concept to Lao PDR, the Lao government will face the same problems as in the cases of China and Vietnam, which were mainly attributable to confrontation of the political system and economic freedom. At least inside the SEZ, the economic freedom has to be respected in every scene. In other words, the policies should follow and serve to the requirement, request, and autonomous movement of the market-oriented economy in SEZ.

2) Organizational Schemes

There are two major categories of Asian SEZ. One is a traditional single-function type and the other is the combined-function type. The Philippines and Thai have an independent operation body connected with the higher public authority. On the other hand, Shenzhen ESZ in China is under supervision of Shenzhen Municipal Government at the local level and there is the Office of Economic Special Zones of Guangdong Provincial Government at the provincial level, which supervises all Economic Special Zones located in the province. Moreover, Guangdong Province itself is under the firmer control of the central government. When this happens, it becomes difficult to run the scheme with flexibility and the investors’ interest would be damaged. Since many investors point out and claim the non-transparency in Chinese scheme, this kind of double control should be avoided. Lao SEZ should be

provided wide independence and autonomy under adequate auditing and checking function, and it should be placed under the jurisdiction of the Prime Minister or equivalent.

3) Functions

Any of the traditional single-type or new combined-type of SEZ is theoretically applicable to Lao PDR. However, in view of the economic and social environment, it is suggested that a combined-type of SEZ be applied in Lao PDR. It should contain manufacturing and non-manufacturing functions such as logistics, light processing, trade and commerce, tourism. In order to reinforce the supporting functions in SEZ, various industries such as education, real estate, infrastructure construction and management should be invited. Details of Savannakhet SEZ functions are discussed in the subsequent chapters.

4) Incentives

With respect to investment incentives, much wider and more attractive incentives should be granted to investors and these incentives will have to surpass the ones stipulated in the existing Foreign Investment Law, Tax Law, Labor Law and other relevant laws, decrees and regulations. The important point is that, although the incentives can be selectively given to the type of investors or industries, they have to be clearly stated and given automatically to any qualified investors. They should not be negotiated on a case-by-case basis or granted at discretion.

The incentives given to the SEZ investors will fall in two categories of fiscal and non-fiscal. They should include but not limited to the following:

i) Fiscal Incentives

- Profit tax holiday: 2-8 years
- Reduction of profit tax: From 20% to 10-15% in case of foreign investment
- Exemption or reduction of turnover tax: Down to a half of the rates stipulated in Article 12 of Tax Law
- Exemption of utilization tax: Exempted for re-export, half rates on fuel for transport company, exempted on beverages for hotels
- Reduction of personal income tax: From 10% to 5% in case of foreign personnel

- Exemption or reduction of minimum tax: Reduction to half a normal rate – 0.5% to 0.25%
- Exemption of import and export duty: Exempted on all the equipment and materials for export or import substitute manufacturing and on selective goods or construction materials for other types of industry
- Modified conditions for calculating taxable income: Stipulations on deductible and non-deductible expenses in Articles 34 and 35, and on carrying-over of loss in Article 36 of Tax Law shall be modified.
- Exemption or reduction of various charges and fees, and withholding tax on remittance or royalties

ii) Non-fiscal Incentives

- Freer use and possession of foreign currencies: Offshore status shall be given to SEZ.
- Fewer regulations on hiring foreign personnel: Free employment of foreign workers within a limit set forth under SEZ Law and Regulations
- Restrictions of worker's rights to some extent: Prohibition of labor strike in SEZ (Setting-up of Labor Relations Office) and simplification and modification of retirement allowances
- Clarification of governmental charges and fees: No charges or fees collected from SEZ enterprises other than these set forth and announced by SEZ Authority.
- Clarification of land lease fees: Land lease fees shall be determined and announced in public by SEZ Authority and the same rates shall be applied to all qualified SEZ enterprises.
- Easier acquisition and faster issuance of licenses such as investment, export and import licenses: One-stop licensing shop to be set up in SEZ with representatives from relevant ministries

Proposed draft of the fiscal incentives applied to Lao SEZ is summarized in the following pages. Those incentives should be principally described in the SEZ Law and the details should be regulated in its Rules and Regulations for Implementation.

Table 5.4 Fiscal Incentives to be granted to the SEZ Enterprise of Foreign Investment

	Manufacturing			Logistics			Commerce		Tourism		Development	
	Export-oriented (min. 70% export)	Import Substitution	General	Warehouse	Transport Company	Forwarding	Wholesale, (Export Agent)	Retail	Hotels	Tour company	Industrial Estate, Factory	Housing, Apartment
Minimum Investment	\$500,000	\$500,000	\$500,000	\$1,000,000	\$1,000,000	\$300,000	\$300,000 (\$100,000)	\$300,000	\$2,000,000	\$300,000	\$2,000,000	\$2,000,000
Profit Tax Holiday	5 years (max. 8 years)	3 years	None	3 years	5 years	2 years	2 years	None	3 years	2 years	3 years	3 years
Profit Tax	10%	10%	10%	10%	10%	15%	15%	15%	10%	15%	10%	10%
Turnover Tax	Exempted	Exempted	Exempted for export and 3-15% for domestic	Exempted	Exempted	Exempted	Exempted for export and 3-15% for domestic	Exempted for export and 3-15% for domestic	Half rates of these in Article 12 of Tax Law (3-15%)	Half rates of these in Article 12 of Tax Law (3-15%)	Exempted	Exempted
Utilization Tax	Exempted	Non-Exempted	Exempted for export	Not applicable	Half of normal rates on fuels (Refund)	Not applicable	Exempted for re-export	Exempted for re-export	Exempted on beverages (Refund)	Non-Exempted	Not applicable	Not applicable
Personal Income Tax	5% for foreign personnel	5% for foreign personnel	5% for foreign personnel	5% for foreign personnel	5% for foreign personnel	5% for foreign personnel	5% for foreign personnel	5% for foreign personnel	5% for foreign personnel	5% for foreign personnel	5% for foreign personnel	5% for foreign personnel
Minimum Tax	Exempted	Exempted	0.25%	Exempted	Exempted	Exempted	Exempted	0.25%	0.25%	0.25%	Exempted	Exempted
Import Duties	Exempted Refund for indirect export	Exempted	Exempted on production machinery & 1% on materials	Exempted on building materials and facilities	Exempted on trucks and loading facilities	Exempted on office equipment	Exempted for re-export Exempted on office equipment	Exempted for re-export Exempted on office equipment	Exempted on facilities	Exempted on office equipment	Exempted on building materials, machinery and facilities	Exempted on building materials, machinery and facilities
Export Duties	Exempted	Exempted	Exempted for exports	Not applicable	Not applicable	Not applicable	Exempted	Exempted	Not applicable	Not applicable	Not applicable	Not applicable

Table 5.5 Fiscal Incentives to be granted to the SEZ Enterprise of Domestic Investment

	Manufacturing			Logistics			Commerce		Tourism		Development	
	Export-oriented (min. 50% export)	Import Substitution	General	Warehouse	Transport Company	Forwarding	Wholesale, (Export Agent)	Retail	Hotels	Tour company	Industrial Estate, Factory	Housing, Apartment
Minimum Investment	\$250,000	\$250,000	\$250,000	\$500,000	\$500,000	\$150,000	\$150,000 (\$50,000)	\$150,000	\$1,000,000	\$150,000	\$1,000,000	\$1,000,000
Profit Tax Holiday	Max. 5 years	3 years	None	3 years	3 years	2 years	None	None	3 years	2 years	3 years	3 years
Profit Tax	10%	10%	10%	10%	10%	15%	15%	15%	10%	15%	10%	10%
Turnover Tax	Exempted	Exempted	Exempted for export and 3-15% for domestic	Exempted	Exempted	Exempted	Exempted for export and 3-15% for domestic	Exempted for export and 3-15% for domestic	Half rates of these in Article 12 of Tax Law (3-15%)	Half rates of these in Article 12 of Tax Law (3-15%)	Exempted	Exempted
Utilization Tax	Exempted	Non-exempted	Exempted for export	Not applicable	Half of normal rates on fuels (Refund)	Not applicable	Exempted for re-export	Exempted for re-export	Exempted on beverages (Refund)	Non-exempted	Not applicable	Not applicable
Personal Income Tax	Normal rates	Normal rates	Normal rates	Normal rates	Normal rates	Normal rates	Normal rates	Normal rates	Normal rates	Normal Rates	Normal rates	Normal rates
Minimum Tax	Exempted	Exempted	0.25%	Exempted	Exempted	Exempted	Exempted	0.25%	0.25%	0.25%	Exempted	Exempted
Import Duties	Exempted Refund for indirect export	Exempted	Exempted on production machinery & 1% on materials	Exempted on building materials and facilities	Exempted on trucks and loading facilities	Exempted on office equipment	Exempted for re-export on office equipment	Exempted for re-export on office equipment	Exempted on facilities	Exempted on office equipment	Exempted on building materials, machinery and facilities	Exempted on building materials, machinery and facilities
Export Duties	Exempted	Exempted	Exempted for exports	Not applicable	Not applicable	Not applicable	Exempted	Exempted	Not applicable	Not applicable	Not applicable	Not applicable