

FDI IN SERVICES – A GROWING BUSINESS FOR EPZs

Export processing zones (EPZs) have traditionally been associated with exports of goods, such as garments and electronics. Service activities have mostly been limited to warehousing and trade facilitation. New research shows that EPZs now often target a broader range of services, many requiring advanced skills. While EPZs can be effective in attracting foreign direct investment (FDI), the challenge is to ensure that benefits extend beyond their fences.

EPZs have long been a popular policy tool to attract export-oriented FDI. In fact, the biggest "winners" in export competitiveness during the past two decades have all established some kind of EPZ. EPZs often account for a large share of manufactured exports from developing countries.

The EPZ concept encompasses different types of zones (e.g. free-trade zones, duty-free zones, special economic zones), reflecting the variety of activities performed in the zones. Despite some variation, export-oriented manufacturing has been the main focus of most zones. Production processes often involve low skills and relatively simple technology, particularly in the garment and footwear industries and in the assembly of electronic components and light machinery goods. While zone firms can be domestic, foreign or joint ventures, FDI generally plays a prominent role.

New information from the International Labour Organization (ILO) shows that manufacturing activities are being complemented by services in many countries' EPZs. More than 90 of the 116 countries with EPZs covered in an ILO website on EPZs (www.ilo.org/epz) promote services. And the range of services located in EPZs is expanding rapidly, from commercial services and simple data entry to call centres, medical diagnoses, architectural, business, engineering and financial services. A regional breakdown of services shows that most EPZs with service industries are located in developing countries (table 1), which means they are an important element of these countries' strategy for attracting FDI.

EPZs that promote services generally advertise the availability of high-quality telecoms, a stable power supply and a well-developed

technology support infrastructure. In addition, they offer a range of incentives, such as 100% exemption from import duties and general sales tax, full repatriation of earnings and preferential customs clearance.

Judging from the information published by zone authorities, access to highly skilled labour is considered an important determinant of FDI in services. Some EPZs provide details on the actual level of education of workers, including the types of degrees obtained, the number of graduates, and the number of universities and training institutes in the vicinity. Various EPZs also emphasize linguistic capabilities. This focus on knowledge workers differs from that of traditional assembly EPZs, which have stressed the availability of low-wage, low- or semi-skilled workers.

In **India**, one of the most successful developing countries in terms of exports of services, much FDI related to the offshoring of services has been attracted to dedicated technology parks. The first such parks were established in 1990 in Bangalore, Pune and Bhubaneswar. As of 2003, there were 39 such parks with about 7,000 units registered, accounting for 80% of the country's software exports. In addition to providing modern computers and communication technologies, they offer such incentives as approvals under a "single-window clearance" mechanism; permission for 100% foreign ownership; five-year tax holidays with no value addition norms; duty-free imports; and permission to subcontract software development activity.

The trend towards "offshoring of services" has fuelled a growing interest among developing countries in using EPZs to attract services FDI. **Mauritius**, for example, is seeking to position the island as a location for FDI in business

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services. To this end, it has initiated the "Cyber City" project to attract call centres, back-office services and programming especially to serve francophone Africa, France and parts of Canada. Cyber City will become a state-of-the-art technology park with office buildings and a world-class telecommunications network. In **Jamaica**, the transformation of manufacturing free zones into "teleports" - corporate parks wired with fibre-optics and satellite technology - has attracted offshored services.

Even a middle-income country like the **Republic of Korea** sees opportunities in this area. In 2002, the Government decided to develop three economic free zones around the Incheon international airport and the Busan and Gwangyang ports, in an effort to make the country a logistics centre and business hub in East Asia for high-value-added services (headquarters functions, trade, finance, IT, design, R&D, leisure and tourism).

While the services sector appears to offer opportunities for upgrading and the creation of new high-value-added jobs, not all EPZs succeed in attracting FDI. Moreover, there is a risk that EPZs may become enclaves with limited interaction with the rest of the economy. As in the case of manufacturing, closer interaction between zone firms and other firms and institutions should be encouraged. Strong linkages of this kind also reduce the risk of footloose behaviour by investors. Caution may also be warranted

regarding the incentives offered, since excessive use of them may significantly limit the benefits to a host economy.

Exports of services should not be the final development goal. It is clear that such exports can, in addition to creating jobs and foreign exchange, also support competitiveness in other activities. They can also create new skills, technical as well as managerial. And they can increase the efficiency of domestic services, spreading new ICT technologies and skills. However, not until a country can provide competitive services more broadly to its citizens and local producers will the gains in GDP growth and human development become substantial. Broad-based gains come as a result of cheaper services inputs to all forms of productive activity, as well as to the transformation of business activities that results when resources are freed up to be used in new business endeavours throughout the economy.

So, from a development perspective, the best impact of EPZs materializes if the business-friendly environment – notably in terms of efficient bureaucracy and good infrastructure – created in the zones eventually spreads to the rest of the country. Such developments can be particularly powerful if combined with efforts to build institutional capacity and upgrade human resources.

Source: UNCTAD.

Table 1. Regional distribution of EPZs targeting services, 2004
(Number)

Region	No. of countries with EPZs for services
European Union	5
Other developed countries	1
Africa	20
Latin America and the Caribbean	26
Asia and the Pacific	26
Central and Eastern Europe	13
Total	91

Source: ILO, www.ilo.org/epz.

For more on this topic, see *World Investment Report 2004: The Shift towards Services* (available online at www.unctad.org/wir).

You can also visit www.ilo.org/epz.