

Diagnostic Studies of Free/Special Economic Zones in the Kyrgyz Republic and Kazakhstan: A Cautionary Tale

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WHY A CAUTIONARY TALE?

“Anecdotal evidence suggests they [SEZs] fall into three broad categories: a few runaway successes, a larger number that come out marginally positive in cost-benefit assessments, and a long tail of failed zones that either never got going, were poorly run, or where investors gladly took tax breaks without producing substantial employment or export earnings.” [*The Economist*, April 4, 2015.]

Similar conclusion in UNCTAD’s *World Investment Report 2018*.

1. PREVAILING VIEW OF SEZS

- In reality, most SEZs fail.
- Even in China, where some SEZs have been runaway successes, 70% have not.
- **China's success is very difficult to replicate** (as India's experience with its SEZs shows).
- DSs throw light on SEZs' economic performance in Kazakhstan & Kyrgyzstan and how it might be improved.

2. PURPOSES OF DIAGNOSTIC STUDIES

- Throw light on whether FEZs/SEZs are cost-effective catalysts for inclusive growth (rather than enclaves).
- Evaluate success of FEZs/SEZs in achieving their objectives.
- Suggest guidelines to improve zones' cost-effectiveness.
- These guidelines reflect international rules & best practices.

3. CONCEPTS & METHODOLOGY

- TFP (and its proxies) key test of economic performance;
- export- & FDI-orientation correlated with TFP & thus wages;
- **facilitation measures vs incentives**;
- incentives justified only on grounds of “market failure”;
- **essential but elusive concept of “incrementality”**;
- importance of transparency & policy evaluation.

4. TAX PREFERENCES: KYRGYZSTAN

<u>Type of tax</u>	<u>Inside FEZs</u>	<u>Outside FEZs</u>
Import tariff	0%	6.9% ¹
Export tax	0%	various rates
VAT (standard rate)	0%	12%
Corporate income tax	0%	10%
Property tax	0%	0.8%
Land Tax	0%	various rates

¹ Simple average applied MFN tariff rate (2016).

5. ESSENCE OF TRANSPARENCY

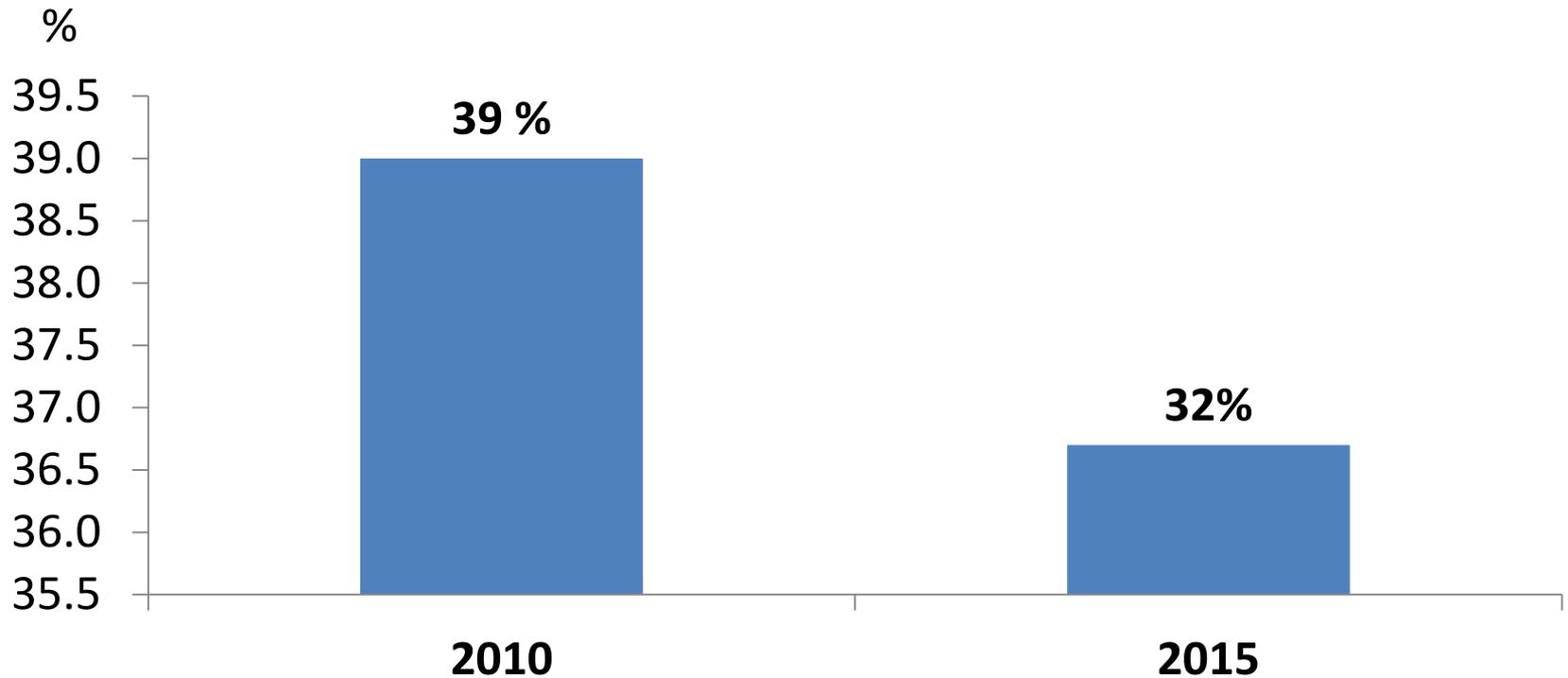
- Description of institutional framework and objectives;
- costs of FEZs/SEZs (fiscal costs and efficiency losses);
- economic benefits (TFP, exports, FDI, etc.) of FEZs/SEZs;
- cost-effectiveness in achieving objectives/benefits;
- Suggest modifications (if not replacement) of FEZs/SEZs.

6. PERFORMANCE OF KYRGZ FEZS

- ✓ FEZs' total production only 1.2% of GDP in 2016.
- ✓ FEZs account for roughly 1% of total employment.
- ✓ 32% of Bishkek's FEZ production was exported in 2016.
- ✓ FEZs' exports account for only 5.3% of total exports.
- ✓ Investment in Bishkek FEZ rose to US\$6 million in 2016.
- ✓ Average monthly wage is relatively low in Bishkek FEZ (Som 12,273 v Som14,479 in 2016).

Bishkek FEZ

Exports as % of production

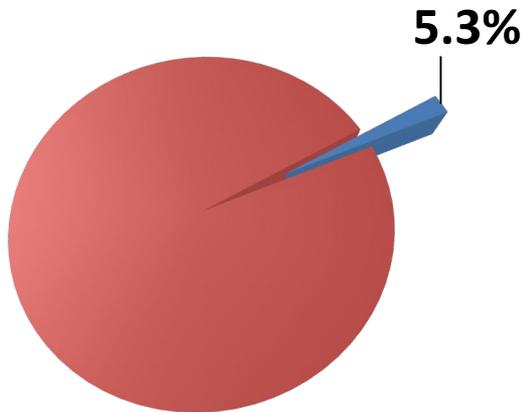


FEZ = free economic zones

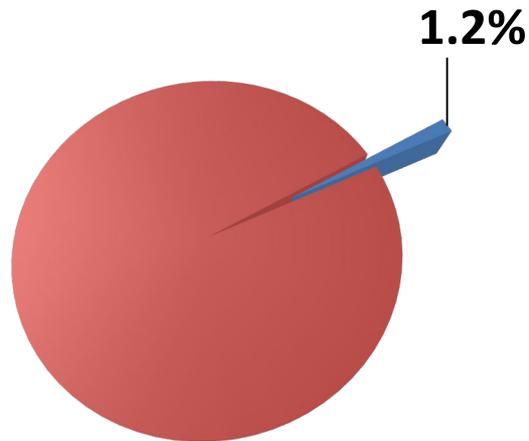
Source: _____

Bishkek FEZs' Shares, 2016

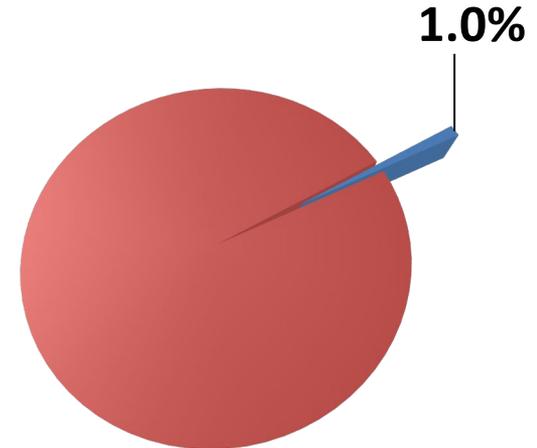
Share of Exports



Share of Production



Share of Employment



FEZ = free economic zones

Source: _____

7. PERFORMANCE OF KAZAKH SEZS

- Only 3 SEZs have achieved their output, investment & jobs targets (the other 7 have yet to take off);
- 10 SEZs' shares of GDP, investment (FDI) and jobs negligible;
- SEZs are oriented largely towards domestic market;
- SEZs accounted for only 0.8% of total exports in 2016.
- FDI accounted for only 8% of total investment in SEZs in 2015.
- domestic market is insufficiently large to enable scale economies.

8A. TENTATIVE GUIDELINES

- 1) Zones' objectives should be clear (with associated numerical targets) and consistent with the goal of improving TFP;
- 2) orient zones outward towards exports rather than the domestic market and facilitate inward FDI (& new technology);
- 3) monitor and evaluate cost-effectiveness of zones' features ;
- 4) evaluate benefits/costs of zones vs basic infrastructure;
- 5) zones' features should comply with WTO/EAEU rules;

8B. TENTATIVE GUIDELINES

- 6) create linkages with local economy (not enclaves);
- 7) **use measures to facilitate trade/investment, not incentives** (which should be used only to correct “market failure”);
- 8) **BTAs should be the same for firms inside & outside zones;**
- 9) **abolish CIT holidays (on efficiency and fiscal grounds);**
- 10) under WTO rules, in the case of goods, incentives should not be contingent upon exports or import substitution, or be “actionable”;

8C. TENTATIVE GUIDELINES

- 11) use short “negative” (not long “positive”) lists of eligibility to permit a wide range of activities, including services;
- 12) “single-windows” should facilitate compliance with streamlined domestic regulations and procedures;
- 13) enhance autonomy and governance of management companies as well as their role in the development of zones;
- 14) require fee-based management and other services inside zones with full cost recovery, if not for profit;
- 15) Locate zones/IPs close to high quality off-site infrastructure and adopt PPP model for infrastructure development;

8D. TENTATIVE GUIDELINES

- 16) require high environmental as well as labour standards;
- 17) foster centres of excellence in collaboration with local firms, educational/training and research institutions; and
- 18) ensure TFP gains from trade liberalization, including the use of zones, and resulting economic growth are inclusive; and
- 19) integrate zones into national (and regional) EDS and ensure cross-border as well as domestic co-ordination among zones, various government bodies, and the private sector.

9. MAIN TAKEAWAYS

- Most SEZs have failed, even in China
- **China's successes are very difficult to replicate.**
- **No convincing evidence of substantial “incrementality”.**
- Little, if any, evidence that zones substantially raise exports, attract FDI, & create highly-paid jobs.
- Guidelines should help improve performance.



Thank you for your attention