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Export processing zones: A country marketing instrument for attracting investments

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This paper is a literature review on the application of export processing zones (EPZs) scheme as a country marketing instrument. In undertaking country marketing, a host nation may use investment promotion incentives, through EPZ scheme. However, the perceived values of such incentives continue to draw mixed reaction. The viability and sustainability of investment promotion incentives have generated debate considering that their funding is usually from public resources. EPZs have faced operational and economic policy challenges despite achieving objectives for which they are developed. The zones earn foreign exchange for the host nation through exports; generate employment; link with domestic economy (backward linkages) and transfer technology and skills to host nation human capital. The paper brings out the theories underpinning the concept of country marketing with theoretical understanding of investment promotion incentives as significant elements for country marketing. From the review there seem to be lack of convergence on the value of investment promotion incentives. An empirical study to establish benefits accruing on or losses arising from the EPZ scheme as a country marketing policy instrument should be carried out. Such a study would be able to determine both short and long-term benefits of investments put in the establishment of the EPZs or any other special economic zone. From the Kenyan perspective, it is also important to determine the real values of investment promotion incentives against the performance of firms benefiting from such incentives. This will provide strong evidence on the relationship between the incentives and benefits accruing to the country.

Key words: Country marketing, export processing zones, investment promotion incentives.

Introduction

In the face of globalization, countries compete for scarce resources that are found in different corners of the globe. Treaties involving bilateral, regional or multilateral relations are negotiated and entered into with intention to exploit opportunities available within the resources in in various territories or regions. The resources may be physical, human or technological. Each country attempts to benefit from the resource endowments that are found within its borders. Some of the endowments may be minerals, agricultural produce, industrial technologies, sports, craftsmanship, natural heritage and tourism products. These resources are further augmented with location, climate and other environmental advantages. In order to create brand awareness and visibility of the resources a country has and may exploit for economic advancement, marketing plays pivotal role. For example, a mention of Kenya in an international forum brings to mind brand products like athletics (sports), wild life (tourism), tea, fresh flowers and coffee (exports).

Investment attraction for foreign exchange earnings, employment creation, technology/skill transfer and backward linkages with domestic economy is the expected product of effective country marketing. Export Processing Zone (EPZ) scheme is one of the country marketing policy instruments that may be used to attract investments. The scheme is often designed to provide lucrative incentives for foreign direct investments. From the investor concept, EPZs are entry strategies used to penetrate the foreign market for competitiveness. This paper reviews EPZs scheme and its incentives in marketing a country as investment location. It thus reviews the nexus between country marketing and investment promotion incentives in export processing zones to attract investments.
**Country marketing**

Country marketing may be described as series or processes of events and programs that aim to strategically create value proposition of a country with a sole purpose of attracting foreign direct investment, tourism destination and source market of exportable products. It is a competitive edge placement with attendant costs and deliverable benefits. It is a significant activity for economic development. Several promotional techniques guided by theoretical underpinnings can be applied by countries to attract foreign direct investment (Wells and Wint, 2000). Some related theories that support country marketing are Heckscher-Ohlin’s Theory of International Trade, Theory of Location Advantage, and Eclectic Theory of Foreign Direct Investment. While Theory of International Trade focuses on classical comparative cost and the interdependence of marketing to societal environment, Theory of Location Advantage is concerned with competitive location factors. The two theories define factors that create competitiveness of countries for promotion of FDI attraction. On the other hand, Eclectic Theory of Foreign Direct Investment defines the understanding of what determines the flow of investments at both macro and micro-levels based on ownership and location advantages as well as internalization.

**Investment Promotion Incentives**

Investment promotion incentive is an offer in country marketing strategy to significantly influence foreign direct investment flows into a country. The promotion incentive activities include providing carefully designed promotion information to potential investors, exhibiting attractive country image as an investment destination, and providing services to existing and prospective investors (Wells and Wint, 2000). It is an offer or subsidy by a government or an institution that ensures simplified investment procedures in order to influence investment location decision (LaRRI, 2000). The incentives are therefore important component of country marketing strategy whose perceived values continue to draw diverse interpretation. The value is determined by quality and price of the offer. The other determinants are utility and price relationships of the offer as well as risk and image of the country providing the offer. Engman, Onodera, and Pinali (2007) posit that the often-offered incentives under EPZ schemes include enhanced physical infrastructure, streamlined administrative services, fiscal incentives, relaxed legal and regulatory requirements, and export promotion services. The modern EPZs have focused on internationally competitive business environment by providing procedural incentives in terms of efficient transport and logistical linkages, state-of-the-art communication networks, efficient customs administration, and reliable utility services. Yang, Wang, Chen and Yuan (2011) used factor endowments, governance, incentive policies and infrastructure as variables affecting firm performance in the EPZs. The focus is also emphasized on stable and predictable macro-marketing environment that resonates well with international best practice.

In the context of this paper, investment promotion incentives are reviewed in relation to their influence on the performance of EPZ firms in Kenya. Perceived value of investment promotion incentives is a charge or cost to the host country. The perception explains the inherent or non-quantified costs and/or benefits arising from the establishment and sustenance of EPZ program. The value perceived thus includes the tax revenue foregone, and expenses related to promotion, infrastructure development, regulatory management, and on the other hand the resultant benefits.

It is argued that perceived value of investment promotion incentives as factors of location competitiveness make significant contribution to the performance of firms in the export processing zones (EPZs). Although the role of investment promotion incentives in country marketing has not been adequately studied, the costs of these incentives are evaluated from the perspective of revenue foregone. The concern over the expenditure on incentives may be countered by the resultant enhanced economic activities. The benefits to host economy may be measured through increased trade, creation of employment, increased foreign exchange earnings, backward /forward linkages and overall improved human resource capacity due to transfer of technology and skills (Madani, 1999). Investment promotion incentives are therefore country marketing instruments designed to create location competitiveness using marketing mix, screening, monitoring and intervening in FDI (Wells and Wint, 2000).

**Export Processing Zones**

Export Processing Zone is a geographic area within the territory of a country where economic activities of certain kinds are promoted by a set of policy instruments that are not generally applicable to the rest of the country (Ge, 1999). It is a special economic zone predominantly focusing on export manufacture and where a government sets special conditions in a limited area which may include physical, social and economic separation from the rest of the country (Madani, 1999; Engman, Onodera and Pinali, 2007). The separation is meant to protect local industry from undue, unlevelled competition as the firms in the zone enjoy lucrative incentives with liberal laws. It is also for ease of control, monitoring, supervision and protection of government revenue from leakage.

There are several terms used interchangeably with the term EPZ. In countries such as China and Singapore, the term used is special economic zones; Malaysia uses the term Free Trade Zone. Other countries use terms such
as Industrial Free Zones, Economic Zones, Industrial Parks, Export Processing Factories, Enterprise Zones and Free ports (Yang, Wang, Chen, and Yuan, 2011; Aggarwal, 2007). The choice of terms is driven by the objective of the country in establishing the economic zone for location marketing. Emphasis may be on industrial development and goods manufacturing, export processing, technology capacity building, and expansion of maritime and trading activities.

Establishment of EPZs has various objectives and roles depending on the needs of the host country. In terms of cost consideration, transnational investors use the EPZ concept to move from high cost to low cost production locations where labour is cheap or competitively affordable. These are locations characterized by low wages, favourable tax structures and relaxed governmental regulations in areas like workplace safety and environmental protection. Ghosal (1987) argues that comparative advantage should also include societal comparative advantage relating to quality, quantity and configuration of material, human and institutional resources available within the bounds of a country. EPZ scheme encourages investor mobility which may have side benefits in terms of universalization of skills as human capital stands the chance of being developed or trained anywhere in the world.

Kenya implemented the EPZ scheme following enactment of EPZ Act, Cap.517 as an investment promotion incentive policy in 1990 to spur economic and export trade development (Namada, 2013). The EPZs in Kenya are regulated by the EPZ Authority created by an Act of Parliament to promote and facilitate export-oriented investments and to develop an enabling environment for such investments (EPZ Act, 1990). The Act provides for a number of fiscal and procedural incentives. The fiscal incentives include ten-year corporate tax holiday and 25% tax rate for 10 years thereafter with exception to commercial enterprises; perpetual duty and VAT exemption on raw materials, construction materials, machinery and other business inputs with exception to motor vehicles and certain fuels; stamp duty exemption; and 100% investment deduction on capital expenditure within 20 years of operation.

Literature Review

Country marketing activities cost huge financial resources and yet there has not been empirical concurrence on the accrued benefits to the host countries. Studies have different views on the performance of EPZs as country marketing policy instrument (Jenkins, 2005; LaRRI, 2000; Wells and Wint, 2000). Studies show that returns on the incentives to the host countries have faced challenges in meeting conceptual expectations (LaRRI, 2000, Angko, 2014). In many countries, resistance against EPZs have been reported especially when it is perceived that investors are “foot loose” type with tendency to exploit workers and fold up. The challenges are cited in areas of inadequate supply of local raw material, governmental attitude and erratic policy changes, unreliable infrastructure such as poor water and energy supply and sub-standard work ethics, investor suspicion among others. These challenges suggest that performance of firms in the EPZs that enjoy the host country - incentive packages may not compare favourably with the perceived value of those incentives offered.

Angko (2014) has however argued in his study analyzing the performance of export processing zones in Ghana that the benefits of free zones are both static and dynamic. First are static benefits that directly promote and diversify exports in order to increase foreign exchange earnings, employment creation and income generation. Second, are the dynamic benefits that refer to technological transfer, labor training and skills upgrading, indirect employment creation, backward linkages and regional development with critical contribution to economic development. The distinction is critical as it gives the policy makers an option on direction to pursue while developing incentive packages. A country has to decide on whether it wants more of static or dynamic benefits. Dynamic benefits appear more permanent and capable of further dissemination than static which largely tends to be temporary. With cost of establishing an EPZ being periodic while benefits are continuous however low in its rate of return, one would justify the establishment of EPZs especially at the early stages of economic development. Furthermore, in cases where mass employment is required, the EPZs may be of immense importance while developing strategic intervention to alleviate unemployment.

Other studies have shown that even with investment promotion incentives offered, a host country needs to create favourable macro-marketing environment for the location to be competitive (Engman, Onodera and Pinñal, 2007; Akhtar, 2003, Wells and Wint, 2000) and firms should have supportive organizational characteristics such as age, size and ownership for effective performance (Ibrahim and Shah, 2012). Akhtar (2003) found that legislation, political climate, good infrastructure and stable fiscal policies had significant impact on performance of EPZ firms. The nature of ownership patterns was affected by various factors such as incentives the host country offers, local partnership scope, legislation and market opportunities (ibid. p.933). However, a study by Wei, Samiee and Lee (2013) found no effect of firm age on firm performance while firm size had marginal effect. But Mayende (2013) found contrary results indicating that firm age had positive effect on performance. His study further indicated that firm size may have foregone revenue when offering investment promotion incentives but with unfavourable macro-marketing environment which negatively impacts on the firm performance, it may not achieve the development object-
The EPZ scheme.

Performance has largely been measured from the perspective of investors and management based on financial and operational indicators such as return on investment, efficiency, sales growth, relevance among other balanced score card instruments (Namada, Aosa, Awino and Wainaina, 2014; Machuki, Aosa and Letting, 2012; Kennerley and Neely, 2003; Kaplan and Norton, 1992). Few studies have used foreign exchange earnings, local employee taxes, employment creation, linkages and technology transfer as performance indicators from the perspective of the host country offering the incentives (Angko, 2014; Aggarwal, 2007; Jenkins, 2005). In analysis of the performance of export processing zones in Ghana, Angko (2014) used export volumes, value addition (net foreign exchange earnings), and employment creation as variables to measure firm performance. Jenkins (2005) reviewed policy instruments for diversification of host nation exports while studying economic and social effects of EPZs in Costa Rica focusing on employment, backward linkages and incentives.

Over time, the EPZ scheme continues to attract criticism concerning its viability and relevance to the host economy as it is often considered sub-optimal policy benefitting a few players while distorting resource allocation (Engman, Onodera and Pinali, 2007; LaRRI, 2000). In contrast, Jayanthakumaran (2003) in a benefit-cost analysis based on S. Korea, Malaysia, Sri Lanka, China and Indonesia concluded that EPZs make positive economic impact for the citizens of the host country. In these countries, the research showed that the EPZs were economically efficient and generated returns far above the estimated opportunity cost.

In Kenya, the EPZ scheme was part of government initiative to substantively liberalize the economy putting in place reform measures aimed at developing trade and investment. The scheme was to provide international standard industrial and business infrastructure such as factory buildings, warehouses, serviced land, office space, utilities and twenty-hour security and custom services. Activities allowed in the zones included export oriented manufacturing or processing, commercial activities and export services (EPZ Act, 1990). However, governmental attitude leading to erratic policy changes have caused several amendments to the EPZ Act over time thus diluting its original intention. Some amendments have for example, introduced exclusion of commercial activities from income tax holidays, and disallowed parallel commercial and manufacturing activities by single enterprise (EPZA, 2012). A duty surcharge of 2.5% over and above payable taxes has been imposed on goods sold into the domestic market with the approval of the minister responsible for industry. These provisions have eroded the perceived positive effect of the incentives offered to the investors in the scheme. The “lukewarm” application of EPZ policy denies the scheme to exploit its full potential in attracting foreign direct investment. Many countries tend to treat the scheme as an “economic trial event” which is detrimental to the overall development of the country due to huge resources used in establishing the zones.

Discussion and Conclusion

With contrasting views over the viability, challenges and constraints in EPZs, empirical investigation into the performance of the Kenyan EPZ firms with special incentives could provide knowledge for policy decision on the incentives whose perceived value is still debatable by scholars and policy makers. The contention over EPZ performance is hardly backed by empirical studies. Most critics contend that the scheme is unworthy use of public funds which only benefits ‘foot loose’ investors who flee whenever the challenges become unbearable. This notion is largely bought by labour movements which frequently agitate for favourable terms and conditions of employment believing that investors are exploiting workers. It may be prudent that all major stakeholders in economic activities in a country are involved in the development of policy on investment promotion incentives. Loewendahl (2001) concludes that investment promotion strategy requires coherent objectives that are agreed upon by all stakeholders and supported by proper analysis of the competitiveness of the location. There should be synergy between industrial and investment promotion policies in order to avoid competing interests that may hurt the overall economic development and marketing policies of the country.

The EPZA annual report for 2013 identifies a number of challenges influencing the performance of EPZ firms in Kenya. The report cites high cost of energy and other utilities that can hardly be compared to competitors in other locations in Africa. Port congestion is also considered a challenge. The main port of Mombasa is a regional hub for sea-bound cargo hence it faced with unprecedented congestion. However, the Kenya government is already fixing the problem by expanding and adding more landing berths and use of dryland container freight stations. Enlarged East African Community (EAC) domestic market has reduced the regional export market for the EPZ products. Sales into the domestic market are only allowed up to 20% of EPZ firm annual production. By the entry of Rwanda, Burundi and South Sudan into the East African Community, these, hitherto, lucrative regional export market have turned into domestic market. Unpredictable market factors caused by the doubts over the extension of African Growth and Opportunity Act (AGOA) of the USA continue to affect the activities of the Kenyan EPZs. African beneficiary countries have been pushing for its permanency without success. These challenges reduce the competitiveness of the programme in attracting FDI.
Given the differing findings from various studies, there is need for empirical study to establish benefits accruing on or losses arising from the EPZ scheme as a country marketing policy instrument. Studies should therefore, be encouraged to determine both short and long-term benefits of investments put in the establishment of the EPZs or any other special economic zone. Furthermore, it is necessary to determine the quantity of perceived value of investment promotion incentives against the performance of firms benefiting from such incentives. This will provide strong evidence on the relationship between the incentives and benefits accruing to the country.

REFERENCES


