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

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“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.]

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

<table>
<thead>
<tr>
<th>Type of tax</th>
<th>Inside FEZs</th>
<th>Outside FEZs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Import tariff</td>
<td>0%</td>
<td>6.9%&lt;sup&gt;1&lt;/sup&gt;</td>
</tr>
<tr>
<td>Export tax</td>
<td>0%</td>
<td>various rates</td>
</tr>
<tr>
<td>VAT (standard rate)</td>
<td>0%</td>
<td>12%</td>
</tr>
<tr>
<td>Corporate income tax</td>
<td>0%</td>
<td>10%</td>
</tr>
<tr>
<td>Property tax</td>
<td>0%</td>
<td>0.8%</td>
</tr>
<tr>
<td>Land Tax</td>
<td>0%</td>
<td>various rates</td>
</tr>
</tbody>
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<sup>1</sup> 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: 5.3%
Share of Production: 1.2%
Share of Employment: 1.0%

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”;
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;
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.
THAT'S ALL
FOLKS!
Thank you for your attention