“ASEAN Guidelines for Special Economic Zones (SEZs) Development and Collaboration”

Contents

Introduction

Special economic zones (SEZ), including export processing zones, industrial parks, eco-industrial parks, technology parks, and innovation districts, are being increasingly used in the economic development strategies of many countries in Asia.

Most ASEAN Member States (AMS) – if not all – opt for special economic zones (SEZs) to attract investors, create jobs and increase export earnings. Common features of SEZs include a geographically defined area, streamlined procedures – such as for customs, special regulations, tax holidays – which are often governed by a single administrative authority. A zone-based strategy may be effective in attracting investors in the short-run by offering efficient and expedited administrative services, adequate infrastructure, services and duty-free access for capital goods and other inputs.

In Viet Nam, SEZs play a key role in the government's FDI attraction strategy. There are currently 295 industrial parks, 3 technology parks and 15 economic zones, which concentrate over 50% of total FDI and 80% of manufacturing FDI. A master plan approved in 2015 provides for the creation of a total of 400 industrial parks and 18 economic zones by 2020. SEZs currently contribute to 40% of GDP and 45% of export value. They employ approximately 2.5% of the workforce, which is rather high compared to the region (e.g. 1.25% in the Philippines and 1.1% in Thailand). SEZs are under the responsibility of provinces, with the central government only having a coordinating role. All 58 provinces have at least one zone (UNIDO, 2015[1] and World Development Indicators).

In Lao PDR, SEZs have been developed since the early 2000s but remain a relatively new concept. Ten zones have been created, and two seem to be fully operational. Savan-Seno in Savannakhet, the first SEZ established in 2002, is particularly appealing to companies wishing to locate on the East-West economic corridor linking Viet Nam, Lao PDR and Thailand. These incipient zone developments have the potential to attract investors from a broader range of economic sectors, thereby contributing to the diversification of the economy, currently strongly driven by natural resource development. The government is preparing a new SEZ law to ensure that zones have their own regulatory framework which reflects good international practice.

Some countries in Southeast Asia increasingly adapt their SEZ strategy to a more elaborate and comprehensive strategy of cluster development, providing a less trade-distorting framework for the support of strategic sectors. A stronger emphasis is given to SME development in an attempt to link industrial and enterprise policies. An interesting example is Penang, which is hosting one of Malaysia's most developed technology clusters in the manufacturing of semiconductor-based electronic components. The Penang SME Centre was established to act as an incubator for SMEs, providing them with rental subsidies to help them take advantage of the facility. Johor and Klang Valley follow a similar approach to industrial cluster development.

SEZs are well developed in Indonesia and employ about 2.5% of the workforce. Batam Free Trade Zone attracted over 150 major international maritime companies, contributing to a booming shipbuilding and shipyard industry, also facilitated by the advantageous position of the Riau Islands

[1] UNIDO (2015) Economic Zones in the ASEAN
https://www.unido.org/fileadmin/user_media_upgrade/Resources/Publications/UCO_Viet_Nam_Study_FINAL.pdf

Province. Batam is also becoming an electronics manufacturing hub and benefits from the presence of global leaders such Panasonic, Sanyo and Siemens. This is in part due to the quality of its infrastructure, which is higher than in the rest of Indonesia.

The Philippines hosts well over 300 economic zones administered by the 18 different investment promotion agencies which have contributed significantly both to FDI inflows and to exports. The Philippines Economic Zone Authority (PEZA) alone owns three ecozones and administers the incentives for over 300 privately-managed zones. These include 21 agro-industrial economic zones, 216 IT parks and centres, 64 manufacturing economic zones, 19 tourism economic zones, and two medical tourism zones (as of May 2015). PEZA has a good reputation among investors for its one-stop, non-stop service. Other major zones include Subic Bay Metropolitan Authority (SBMA) and Clark Development Corporation, which all form part of the country's network of IPAs. The SBMA was the overall winner for Asia in 2015 of the FDI Global Free Zones Award, owing in part to its performance in encouraging reinvestment (OECD, Investment Policy Reviews, Philippines, 2016).

In Cambodia, the legal framework for SEZs was established in 2005. There are currently 34 approved SEZs, of which 14 were operational as of September 2015. These zones are nevertheless relatively small and account for a low share of total investment and employment: 68 000 as of 2014 or less than 1% of total employment and 3.7% of total secondary industry employment (Warr and Menon, 2015, Cambodia's SEZ). Most are located along the borders with Thailand and Viet Nam, particularly in Sihanoukville and Phnom Penh. In the case of the Philippines, these SEZs are often privately owned. These zones have helped to start diversifying the industrial base away from garments towards electronics and electrical products, as well as household furnishings and car parts.

Myanmar opted early on in its reform process to develop SEZs to attract foreign investment. The first SEZ in Myanmar, the Thilawa Special Economic Zone, began operation in late 2015. Majority of the roughly 60 businesses to set up at Thilawa are Japanese, although investors from China, the United States, Thailand and other countries are also present. Sectors include manufacturing of garments and toys, steel products, radiators, aluminium cans, packaging and waste management. As in other AMS, the SEZs in Myanmar could be used as effective pilot schemes for testing new approaches to boost the investment climate, such as in the area of building capacity for monitoring the environmental, social and economic impact of investments in the zones, streamlining registration and licensing procedures, effectively managing incentives, and promoting linkages.

SEZs in ASEAN have been at the heart of export-led development strategies of Asian economies over many decades. They have attracted significant FDI, boosted exports and created millions of jobs – including for women – and have assisted economic diversification. At the same time, these zones have often failed to sustain innovation and competitiveness over time, with little technological upgrading or new firm creation. Most of the jobs created are low-skilled and concentrated in low-technology manufacturing operations. With few exceptions, zones tend to work in enclaves and generate few backward linkages with domestic companies. In some countries, decentralised policymaking for developing zones tends to lead to excessive competition between provinces and a misuse of resources and land when zones are only partially occupied. SEZ development needs to be firmly embedded in a wider development agenda, including appropriate connectivity to the rest of the economy and reduced barriers to investment, to be able to generate stronger linkages with domestic firms.

In order to fully utilize the ASEAN Guidelines for SEZ Development and Collaboration, ASEAN Member States could also work towards a common understanding of the definition of SEZs, taking into consideration that each AMS uses a different terminology to define SEZs.

Designing and implementing successful SEZ strategies is challenging, even more so improving the operation of existing SEZs. A favourable regulatory regime, a compelling master plan, and excellent infrastructure are necessary but not sufficient for SEZs to attract and sustain investment, create jobs, and generate spill-over effects for the rest of the economy. In addition, SEZ programmes have to be relevant to the specific local, national, and regional context in which they are used, efficiently designed, and managed in a flexible manner. Evidence suggests that the balance between costs and benefits of SEZs is not clear-cut. SEZs can create distortions within economies. These include the costs in terms of required infrastructure investment, few linkages with local economies, and forgone tax revenues. Insofar as the effects of zones are hard to disentangle from other economic forces, measuring performance of SEZs' policies is often difficult.

To help policy makers address these challenges, the Guidelines below outline good policy practices for SEZ policies in ASEAN.

ASEAN Guidelines for SEZs

The Guidelines are divided into chapters addressing different aspects of SEZ policy making, strategy development, regulation, and implementation. Chapter 1, "Promotion of clear development strategy", focuses on the importance of a clear strategic direction, firmly ensconced within the broader economic development strategy of the country and the region and tied to quantifiable targets. Chapter 2, "Clarification and separation of roles and responsibilities of institutions", outlines how to align institutional incentives while minimising potentialconflict of interest or corruption risk. Chapter 3, "Delegation of authority and ensure co-ordination between SEZs and other institutions", addresses the importance of coordination between investing SEZ institutions and institutions in providing high-quality infrastructure, administrative services, and utilities. Chapter 4, "Provision of necessary resources and build strong institutional capacities", advises on how to ensure sufficient, predictable budget resources for the zone programme, as well as how to build up and sustain the capacities of its staff. Finally, chapter 5, "Increase ASEAN SEZ co-operation", contains guidance on areas for joint action at the ASEAN level.

The table below is an overview of the guidelines attached to each of the 5 chapters.

Table 1: Chapters and frameworks

Chapter	Guidelines
1. Promotion of clear development strategy	1. SPECIFY IN DETAIL THE PROBLEMS THAT THE ZONE PROGRAMME SHOULD ADDRESS 2. SET MEASURABLE AND TIME-BOUND OBJECTIVES 3. CONSIDER SEZs AS A FRAMEWORK FOR TESTING AND CATALYSING ECONOMIC REFORMS IN THE ECONOMY AS A WHOLE 4. ENSURE COHERENCE BETWEEN SEZs AND THE OVERALL ECONOMIC POLICY FRAMEWORK OF THE COUNTRY AND THE REGION 5. PLAN CONCRETE MEASURES TO PROMOTE LINKAGES BETWEEN SEZ TENANTS AND THE DOMESTIC ECONOMY 6. ENSURE COHERENCE AND COST-EFFICIECY, OF INCENTIVES 7. ENGAGE ANCHOR INVESTORS AND OTHER STAKEHOLDERS EARLY IN THE DESIGN PHASE
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Chapter	Guidelines
separation of roles and responsibilities of institutions	ESTABLISHMENT OF NECESSARY INSTITUTIONS AND REGULATIONS 9. IDENTIFY INSTITUTIONS RESPONSIBLE FOR ZONE REGULATION AND ZONE OPERATION 10. ENSURE COMPLIANCE OF INFRASTRUCTURE INVESTORS IN SEZs –WITH EACH ASEAN MEMBER STATE DOMESTIC REGULATION 11. ENSURE MEASURABLE AND SUSTAINABLE MONITORING AND EVALUATION OF THE ZONE PROGRAMME
3. Delegation of authority and ensure co-ordination between SEZs and other institutions	12. PROVIDE CLEAR DELEGATION OF AUTHORITY 13. PROVIDE EFFICIENT AND PROFESSIONAL ADMINISTRATIVE SERVICES 14. SET UP PROPERLY DESIGNED ONE-STOP SHOPS
4. Provision of necessary resources and building strong institutional capacities	15. ENSURE PROFESSIONAL HUMAN RESOURCE MANAGEMENT AND ACCESSIBILITY FOR SEZ. 16. PROMOTE GOOD GOVERNANCE
5. Increase ASEAN SEZ co-operation	17. SUPPORT SEZ CO-OPERATION AND PROMOTION ACROSS ASEAN THROUGH POLICY AND EXPERIENCE DIALOGUES/ SHARING 18. EXPLORE ASEAN CO-OPERATION ON ZONE CONNECTIVITY, PARTICULARLY FOR ZONES IN BORDER REGIONS ENGAGED IN INTRA-REGIONAL TRADE. 19. EXPLORE CO-BRANDING AND CO-MARKETING SEZs IN THE ASEAN REGION.

Chapter 1: Promotion of clear development strategy

This chapter addresses essential issues that are often not sufficiently addressed in practice: setting clear measurable targets, based on explicit assumptions about the role SEZs could play within the broader policy framework of the country or region. It highlights the need for careful, inclusive strategic planning, independent monitoring and evaluation, and avoiding pitfalls such as ending up with zones poorly linked to the rest of the economy for reasons ranging from formal restrictions on domestic market access to poor capacities of domestic SMEs to meet the exacting standards of global value chains.

1. SPECIFY IN DETAIL THE PROBLEMS THAT THE ZONE PROGRAMME SHOULD ADDRESS

Many SEZs have failed in delivering value for money. Although a clear cost-benefit analysis is difficult due to the complexity of the issue and challenges in measuring spill-over effects, there is evidence that, in many cases, SEZs not only yield insufficient social returns for the economy, but also distort economic incentives and leads to capital misallocation[2]. This is even more the case if factors such as marginal infrastructure spending and forgone tax revenue are taken into account. As it has been pointed out, SEZs tend to fall into three broad categories: a few highly visible success stories, a larger group breaking even or yielding marginal returns for the economy, and a long tail of failed zones that

[2] See, for example, the introductory chapter of "Special Economic Zones Progress, Emerging Challenges, and Future Directions", Thomas Farole, Gokhan Akinci Eds. World Bank 2011, available at: https://openknowledge.worldbank.org/bitstream/handle/10986/2341/638440PUB0Exto00Box0361527B0PUBLIC0.pdf?sequence=1

either were not sustainable or simply provided investors with tax breaks without leading to additional employment opportunities or export earnings.

For that reason, the SEZ programme should be firmly nestled in an analysis of the market failure the programme wants to address and the changes in mind-set and, eventually, the structure of the economy it hopes to contribute to. On that basis, policy makers can then define clear objectives and performance criteria can be specified. These objectives could fall into one or more of the following general categories:

- Compensation for difficulties in the business climate, in particular as a result of lacking infrastructure or regulatory burdens;
- Encouragement of new activities in the economy;
- Promotion of innovative, R&D intensive activities in the economy; and
- Test subject of reforms and different economic policies before they are extended to the rest of the economy.

Either way, zones should be used as a step in promoting the structural change needed for sustainable growth of the economy.

2. SET MEASURABLE AND TIME-BOUND OBJECTIVES THAT ARE EASILY MONITORED AND EVALUATED

All too often, policy makers are overly ambitious in setting objectives for SEZs – aimingto promote investment, encourage innovation, transfer modern technologies, encourage the private sector, develop human resources, protect investors, expand exports, and reduce unemployment. Many similar documents in other countries also call for regional development, increasing female labour force participation, promoting integrity, and streamlining corporate governance.

All of these objectives are laudable, but too many objectives dilute focus and are often too broad to offer meaningful guidance. Although most objectives are aligned (e.g. foreign investment generally leads to job creation), sometimes there are also clear conflicts. A foreign carmaker may insist on locating close to the capital, paying no heed to regional development. A high-tech company may transfer technologies, but make little contribution to employment. A consumer goods manufacturer may package products for the domestic market only, with no intention of exporting.

A clear focus on, for instance, attracting foreign investment with clearly defined characteristics aligned with the factor endowments on offer, would make decision-making, investments, and supporting initiatives considerably easier. Other objectives, such as employment and the creation of an industrial base that may spawn strong exporting companies, will be met – but they should not be key decision-making criteria. A common mistake is to locate SEZs in rural areas, often with regional development objectives in mind, or selecting a site with insufficient connectivity that ends up not being attractive to investors.

Policy makers can, at best, make educated guesses about the success of a planned SEZ; in particular if it targets new, untested sectors. For that reason, SEZs need clear and measurable objectives that are integrated into wider economic development policies and subject to continuous monitoring and evaluation. In particular, the objectives serve to ensure that zone tenants engage in activities that are competitive rather than dependent on direct or indirect incentives.

3. CONSIDER SEZs AS A FRAMEWORK FOR TESTING AND CATALYSING ECONOMIC REFORMS IN THE ECONOMY AS A WHOLE

Very often, the direct and indirect incentives and advantages that zones may offer investors become entrenched. This will distort competition, giving zone residents advantages compared to firms in the rest of the economy for an indefinite period. It may also lower the political momentum for reform of the overall business environment, as the option to locate in a zone may be sufficient for the private sector players who would otherwise lobby for further reforms. Further, it can also aggravate the gap between enclaves of foreign investment which act as offshore entities and the rest of the economy, thereby hampering the potential to create linkages between foreign and large companies on the one hand, and domestic and small and medium enterprises on the other hand. Furthermore, established zone enclaves may disadvantage domestic SMEs by providing advantages that de facto only benefit large, often foreign companies.

As such, policy makers considering various types of SEZs should see them not as a permanent solution, but as a testing ground for economic reforms (including reforms required by ASEAN commitments) and investments that then could be expanded to the rest of the economy, according to a clear time plan, and make only limited use of special regulatory regimes. In particular, SEZs could alleviate the burdens imposed by infrastructure and regulation in several ways – and many of the more recent types of SEZs focus on these particular aspects; Table 2 provides some indicative examples:

Table 2: Indicative list of issues that SEZs can alleviate for residents

Category	Issues	How SEZs can alleviate them
Infrastructure	Available number of land is low	The feasibility of increasing land availability may be explored
	Legal framework to ensure property rights is not sufficient	The possibility of assuring property rights to residents may be explored
	Utilities unreliable or not available; contracting with state utility companies is cumbersome	Utilities can be provided to high service standards in a limited area and adopt an expedited process administered by the zone operator and based on an MoU with the utility companies
	Transport infrastructure is insufficient	Zones could be located on plots with excellent connections over road, sea, and air.
Regulatory burden	Business registration and licensing is often cumbersome	Procedures carried out by a one-stop shop with delegated authority can be simplied for zone residents
	Immigration visas and work permits are difficult to secure and unreliable	Procedures andspecific exceptions for zone residents may be expedited, allowing them to bring in expertise from abroad under specific conditions
	Lengthy customs procedures/ clearance	Either locate zoned outside the customs area of the country, or expedite and

Category	Issues	How SEZs can alleviate them
		simplify customs procedures.
	Property registration and construction licensing process are often lengthy, costly, and unpredictable	Clear zoning restrictions can delineate restrictions on construction and allow for automatic approval of standard types of structures such as factory shells. Property rights can be fixed in the contracts with zone tenants.
	Trading across borders are often difficult due to slow, costly, unpredictable customs procedures and restrictions	The one-stop-shop run by the zone operator could expedite export procedures based on delegated authority and a contractual commitment to certain service standards towards zone tenants.

4. ENSURE COHERENCE BETWEEN SEZs AND THE OVERALL INVESTMENT POLICY FRAMEWORK OF THE COUNTRY

SEZs and the services and incentives they offer should complement the overall economic development strategy and in particular be coherent with the overall investment policy framework.

For example, enterprise support policies could help suppliers to anchor investors in a zone, and investment promotion and concessional finance instruments could help generate strategic zone investments. Utilities and infrastructure must be provided in a reliable and affordable fashion, and supplier linkage programmes could also help strengthen local companies. Zones in the Philippines, for example, failed to build linkages to the local economy in part because of trade restrictions imposed on merchandise produced in the zones. Many zones in other regions of the world failed to attract investors because, while infrastructure in the zone itself was top-notch, the road infrastructure around it was poor and electricity services are unreliable imposing inordinate costs on entrepreneurs. Restrictive visa regimes in other regions prevented investors from bringing in targeted expertise not available in the local work force.

Another set of questions concern the motivation for using SEZs as a policy instrument. Are zones the appropriate economic tool to tackle those particular market failures (or would sector-wide incentives, a value-chain approach, a cluster initiative or some other incentive be more effective)? Too often, these questions are not answered, let alone considered carefully from a value-for-money perspective. The result is often a raft of unintended consequences, unnecessary risks for all parties, and market distortions that deter long-term investment. The OECD Policy Framework for Investment supports overall coherence of policies affecting investment. Furthermore, respect for laws, regulations and international standards protecting labour rights, the environment and other areas of responsible business conduct are important for SEZs. International standards like the OECD Guidelines for Multinational Enterprises or the UN Global Compact can provide important benchmarks for responsible business conduct.

5. PLAN CONCRETE MEASURES TO PROMOTE LINKAGES BETWEEN SEZ TENANTS AND THE DOMESTIC ECONOMY

A common critique of SEZs, in particular free zones and export processing zones, is that the effects on the rest of the economy are limited. While this separation is often a by-product of customs and other exemptions, integrating SEZs with the rest of the economy is important for several reasons, and there are ample business opportunities in supplying zone tenants with raw materials, intermediate goods, and services. Positive spill-over effects include spin-offs, establishment of new sectors, and introduction of new technologies. But, perhaps, most importantly: local clusters have been proven to support company upgrading and specialisation – a central concern in ASEAN, especially for countries facing the "middle-income trap".

While policies that mandate local content in exports tend to distort economic incentives and discourage investment overall, policy makers have a range of options to counteract these problems. Business linkage programmes could help local companies develop and upgrade to meet the quality standards zone tenants expect, and governments can support joint research and development efforts involving MNEs and local companies. Turnover of skilled labour, in particular, helps diffuse technology and know-how. Incubator programmes can also help entrepreneurs take advantage of supply opportunities. In order to spur innovation, policy makers could promote linkages with local universities. Some countries have targeted a higher share of domestic investment.

Often, pilot committees and the board of directors of the regulator include broad private sector participation, although final oversight should remain in the public sector. A pilot committee should have around 10-12 members and enjoy institutional independence, often with full voting rights for non-public-sector members. In the pilot phase, it would propose policies and monitor implementation; later, it could become the board of the regulator itself.

Realising that the lack of backward linkages to electronics companies operating in the many SEZs of the country not only limits positive spill-over effects on the rest of the economy, but leaves the country vulnerable to investors opting for locations with lower labour costs, the Philippines' Department of Trade and Industry has recently co-operated with leading investors in the sector, business associations, academia, NGOs, and entrepreneurs as part of a concerted, multi-faceted effort to upgrade the capacities of the private sector so that local SMEs can take advantage of the opportunities to participate in the global value chains already physically present in the country[3]. Similar efforts are underway in the automotive sector (Viet Nam and Thailand) and infrastructure (Bombardier).

6. ENSURE COHERENCE AND COST-EFFICIENCY OF INCENTIVES

Fiscal and in-kind incentives are frequently part of the policy package to attract investors to SEZs. Fiscal incentives often take the form of investment tax incentives. As a consequence of inter-country competition, a package of fiscal incentives has become almost standardised among zones across the world – corporate tax exemptions, duty free imports, and exemptions from foreign exchange controls rank among the most common. As is the case with many economic development policies, there is a risk that incentives are captured by interest groups and other unintended groups, which

[3] See for instance "FOSTERING LINKAGES BETWEEN MULTINATIONAL AND DOMESTIC FIRMS IN THE PHILIPPINES" Foreign Investment Advisory Service, World Bank and International Finance Corporation, available at: http://siteresources.worldbank.org/INTPHILIPPINES/Resources/Lall-word.pdf; for another example of successful SEZ/linkage policies, see: ATTRACTING KNOWLEDGE-INTENSIVE FDI TO COSTA RICA: CHALLENGES AND POLICY OPTIONS, OECD Development Centre 2012. Available at: http://www.oecd.org/countries/costarica/E-book%20FDI%20to%20Costa%20Rica.pdf and OECD Investment Policy Reviews: Costa Rica (2012).

may potentially have harmful consequences. In addition, tax incentives are a drain on scarce public resources.

According to a report prepared at the request of the G20 Development Working Group by the staff and secretariats of the International Monetary Fund, Organisation for Economic Co-operation and Development, the World Bank and the United Nations[4], tax incentives are not usually a necessary condition for attracting investors, and they are only likely to work where enabling conditions (concerning infrastructure, governance, etc.) are met. There is evidence that tax incentives are often poorly designed and redundant. Tax holidays and income tax exemptions are often used but have been subject to widespread abuse, and their effect on enticing investment in higher risk, innovative and entrepreneurial activities is particularly limited as they are only relevant when profits are made. Investment tax credits and accelerated depreciation are likely to be more effective in stimulating investment. Tax incentives are more likely to work where they target export-oriented sectors and mobile capital, but this can result in stronger tax competition.

Competition among countries on fiscal incentives risks triggering a race to the bottom, which in turn narrows the fiscal room needed to invest in public goods for long-term sustainable development. In this regard, it is of vital importance that fiscal incentives should be fully compliant with the requirements of the OECD/G20 base erosion and profit shifting (BEPS) project and, in particular, the minimum standard on countering harmful tax practices, to reduce opportunities for tax avoidance and limit negative spillovers. In addition, the implicit export subsidies that such incentives create are increasingly at odds with the rules-based WTO trading system. Consequently, as discussed in Chapter 6, regional and international co-operation in this area is useful to mitigate adverse effects.

To guide policy makers on how to avoid these problems, the OECD recommends, in its 2003 Checklist for Foreign Direct Investment Incentive Policies, that:

- Any incentive should have an expiration date, after which the incentive either becomes available to all investors, or expires;
- Incentive regimes should be simple and transparent. Regimes are often complex, requiring multiple interactions with different agencies. Instead, regimes should be simple, easy to understand, and to apply for;
- Incentives should include the totality of regulations, benefits, and exemptions that favour economic activity. Land access, a pre-feasibility study for a specific project, or concessional finance secured through government guarantees are also incentives;
- Incentives should target new activities and new sectors where the risks of cost recovery are prohibitively high for investors, instead of benefiting established industries;
- The performance and impact of incentives should be monitored closely to ensure that vested interests are not entrenched to the detriment of the developmental goal.

7. ENGAGE ANCHOR INVESTORS AND OTHER STAKEHOLDERS IN THE DESIGN PHASE

Marketing, promotion and negotiation with potential anchor investors are crucial to effective zone development. Anchor investors can defray zone development risk considerably, not only through a

[4] http://www.oecd.org/tax/tax-global/options-for-low-income-countries-effective-and-efficient-use-of-tax-incentives-for-investment-call-for-input.pdf.

stable revenue flow but also by signalling to other potential users that the SEZ is a serious investment destination. This can be essential for the zone to be successful: the METU Technopark in Ankara, Turkey, for example, gained much of its traction from the decision of Cisco to invest heavily in the venture, focusing first on manufacturing-related services for the Turkish markets and certifying engineers, but later on moved into research and development.

Developers can engage with anchor investors in a "process of discovery", attempting to tailor SEZ offerings to private sector needs. The pilot should thus have a design that is flexible enough to accommodate the needs of users and adapt to market conditions. In some cases, early investors will insist on having a say in the design in exchange for their investment commitment. The Government, which most likely provides the bulk of the finance, will have to ensure that the design costs involved are justified by the expected social returns of having a major investor setting up shop in the zone. Simultaneously, the circle of stakeholders should be broadened to include potential zone residents, Government agencies, and civil society.

Chapter 2: Clarification and separation of roles and responsibilities of institutions

This chapter stresses the importance of separating clearly the different roles and responsibilities in the zone programme, ensuring efficiency and minimising potential conflicts of interest. At a minimum, a SEZ programme includes the roles of zone owner, developer, operator, and regulator. Until recently, it was common that one single agency not only regulates zones, but also develops and operates them. The increasing number of governments engaging the private sector in zone development and operation, thus benefiting from their expertise and sharing the risk more efficiently could be increasingly problematic and may impede the licensing of competing private zones.

The table below outlines the roles and responsibilities in a typical SEZ programme. The guidelines in this chapter guide ASEAN policy makers on how to put in place the right institutional incentives, both by separating functions and efficient monitoring and evaluation.

Table 3: Roles and responsibilities in an SEZ programme[5]

	Primary responsibilities
Government	• Conduct strategic planning • Select site(s) and package land / establish land use guidelines • Conduct initial feasibility studies • Select and enter development agreement with developer • Develop offsite infrastructure • Training / workforce development and social services • *Regulation and administration of the SEZ program (see below)*
Regulator	• *Designate SEZs*: Designate public and private land as SEZs and public or private SEZ developers and/or operators.

[5] Source: Farole, T. and Kweka, J. Institutional best practices for special economic zones: an application to Tanzania. World Bank Africa Trade Policy Notes No. 25, 2011.

	Primary responsibilities
	• *Facilitate government services*: Facilitate licensing, registration and permits (environmental, building, work permits etc), regulate services within the SEZs such as utilities, provide for dispute resolution; the regulator may set fees commensurate with the cost of service delivery. • *Monitor compliance*: Monitor compliance with the SEZ legal framework, including SEZ policies, standards and requirements, and enforce compliance through appropriate penalties independently from other public agencies.
Developer	• *Land use planning*: Create a final land-use master plan, and prepare the land (grading, leveling, other pre-construction activity) • *Provision of infrastructure*: internal road networks, drainage and sewerage, and infrastructure for provision of utilities.
Operator (May be same as developer or under a contractual agreement with the owner/ developer)	• *Facility leasing*: Managing lease and rental agreements with individual investors and responsibility for main services of the zone (including maintenance, security, etc.) • *Transacting utilities*: Ensuring provision of on-site utilities (electricity, gas, water, telecommunications) through own provision or via domestic providers. • *Provision of other value-added services*: May include a wide range of other services including business and training centers, medical and childcare, transport, recruiting, etc. • *Marketing*: Experienced private developers often have a network of multinational clients across a range of industries to which they can market new SEZ opportunities. Note that the SEZ authority / regulator and other parts of government (such as an investment promotion agency) typically also carry out some marketing activities.

8. ENSURE THAT LEGISLATION COVERS ALL RELEVANT ASPECTS INCLUDING THE ESTABLISHMENT OF NECESSARY INSTITUTIONS AND REGULATIONS

In many cases, governments use a dedicated SEZ law with accompanying implementing regulations and operating procedures to govern an SEZ program. This approach is adopted as an alternative to amending existing frameworks, because it ensures sustainable, not temporary, legal reform, and makes the bold statement of departure from “business as usual”.

SEZ laws and implementing regulations operate at a high level and are edicts that give effect to policy. Operating procedures provide SEZ personnel with commonly distributed interpretation and guidance on the application of policy and law. Both sets of legal instruments are essential in the development of a well-designed SEZ programme.

9. IDENTIFY INSTITUTIONS RESPONSIBLE FOR ZONE REGULATION AND ZONE OPERATION

There are several roles in the administration of SEZs that should be clearly separated in the institutional framework:

1. **Government**: Strategic planning, land use guidelines, offsite infrastructure, social services, pilot phase co-ordination.
2. **The regulator**: The regulator regulates and oversees zones, often with special jurisdiction over the zone territory and the ability to delegate authority to the zone operators. Its responsibilities should also include zone designation, licensing, facilitation of government services, and compliance monitoring.
3. **The zone developer**: Although, in the pilot phase, the regulator often leads zone development as well, institutional separation avoids conflicts of interest. Developers can be private investors, often real estate developers, a public corporation, or a PPP arrangement (special purpose vehicle). They plan the zone, engage tenants, and secure financing.
4. **The zone operator**: Private companies often take over operation and promotion of the zone. Financed by zone user fees, operators maintain infrastructure, recruit zone tenants, enforce rules, and, in some cases, carry out administrative services.
5. **The zone users or tenants**: Users, or resident firms, set up operations in the zone. Some zone users are "anchor tenants", or large firms which, in exchange for concessions, agree to operate in the zone and helps attract other, smaller tenants. Although some functions are distinct for different parties, in practice there is often an overlap in functions, especially at the regulatory and development stages.

In the pilot phase in particular, several of these functions are often conflated – the regulator may also play the role of the developer, the financier, and even the operator. While this may be the easiest solution in the pilot phase, policy makers should have a clear roadmap for institutionalising formal separation between the different roles in the medium to long-term – at the very latest, once the zone programme reaches a certain critical mass with multiple zones in operation or under construction.

Regardless of the nature and extent of private sector involvement, SEZ operation and development should be separated from zone regulation and monitoring. This is not only to avoid conflict of interest, but also to allow the zone regulator to focus on strategic issues rather than the commercial success of individual zones. However, regulators may conflate the two roles in the pilot phase, making clear that the separation will enter into force after a certain time period or once certain objectives have been reached (such as the establishment of the first zone resident). After this phase, however, the regulator should strike a delicate balance between autonomy (independent regulation) and proximity with the private sector. Too much autonomy and regulation will hinder investments and fail to meet the needs of investors; too much proximity and privileges will become entrenched and markets will be distorted.

10. ENSURE COMPLIANCE OF INFRASTRUCTURE INVESTORS IN SEZS WITH EACH ASEAN MEMBER STATE'S DOMESTIC REGULATIONS

Zone development requires foremost the provision of attractive infrastructure. It is important to remember that the party responsible for the equity investment in the zone development, be it public or private, will expect to retain full control of the investment under regular corporate governance standards and in full compliance with the domestic regulations. A publicly funded corporation may hold a specific mandate, which can be modified at regular intervals, and within certain pre-defined limits, but decisions should, by and large, be commercial in nature. Failing that, the government may end up subsidising unproductive investments, either directly (through cheap land, and/or incentives) or indirectly (by limiting competition, trade barriers, or the creation of natural monopolies), leading, as often is the case with industrial policy, to a net destruction of capital for the economy. Ensuring that zone development is seen as a commercial investment, even if the funds are public, instituting appropriate corporate governance, and ensuring that investor interests are represented will help avoid such destructive dynamics.

The basis for these decisions should be an economic and financial analysis estimating the economic rate of return, including all direct and indirect benefits and fully compliant with each ASEAN Member State's domestic regulations. Given the risky nature of many new SEZ programmes, an expected return on investment of between 15%-20% is typical – but the economic analysis will provide a range of different scenarios and guidance on how to react to them.

There is a considerable difference between zone regulation and managing zone investments. The regulator will not be equipped to manage the multi-million dollar assets needed to develop SEZs; an independent body, set up under commercial principles but with a clear public mandate, is better placed to do so, be it directly, through PPP arrangements, or in joint ventures with foreign investors. This also helps demonstrate the financial viability of investing in SEZ development. In environments where trust in public accounting is low, investments should be channelled into the pilot zones through publicly funded but for-profit corporations, with funding from, say, public sector employee retirement funds, and with regulatory rather than administrative oversight by the Government.

11. ENSURE MEASURABLE AND SUSTAINABLE MONITORING AND EVALUATION OF THE ZONE PROGRAMME

A lack of effective monitoring and evaluation is a critical weakness in most SEZ programmes. M&E links results back to the overall strategy and objectives and should be an essential part of decision making and sustainable zone governance. The SEZ strategy should be clear on how success is defined and measured, and the M&E process should include auditors, zone residents, and the private sector more broadly.

Given the closed and regulated nature of zone programmes, assembling the necessary data is relatively straightforward. In addition to revenues, the regulator could conduct regular annual surveys to capture a fuller picture.

The regulator should set up a series of indicators to monitor the success of the project. A host of tools and methodologies to handle indicators must be in place , and monitoring should be stringent, regular, and match political commitments. As investment zones will mask incentives, monitoring performance is particularly important – it has to be clear to all parties involved that any activity that fails to meet certain performance criteria will be discontinued. A private developer that fails to attract a minimum number of zone residents, for example, should face consequences.

Chapter 3: Delegation of authority and ensure co-ordination between SEZs and other institutions.

A common rationale for SEZs is to liberate investors from the burdens imposed by the business climate, be it in terms of onerous regulations, overweening costs of compliance, patchy infrastructure, or lacking suppliers. As a result, policy makers have to consider two options. The first, positioning the SEZ regulator or developer as a co-ordinator and leaving authority for various Government services elsewhere in the administration, requires the SEZ authority to provide the guidance needed to reach the intended performance standards. The second, delegating authority to the SEZ regulator or developer or even operator, is often attractive in countries in dire need of a short-term solution while engaging in longer-term reforms – this option is particularly common in apolitical or graft-prone functions such as business registration and customs respectively.

An efficient solution to these issues is essential to setting up a functioning one-stop shop that provides investors with the efficient, reliable public services they expect.

Another challenge is ensuring cross-ministerial co-ordination – a zone programme is essentially horizontal in nature, involving a wide range of public services, from business registration and licensing over infrastructure and utilities to investor protection. A related issue is cross-agency co-ordination: as zone institutions often take over functions which are in parallel carried out by other agencies, such as investment promotion, co-ordination and alignment are often lacking. There is a strong need to ensure a coherent national investment promotion strategy so that SEZ and non-SEZ investment promotion authorities pursue complementary promotion policies.

12. PROVIDE CLEAR DELEGATION OF AUTHORITY

The regulator must enjoy clear delegation of authority, be subject to explicit, independently monitored targets, and be able to recruit staff with the right capabilities.

Weak administrative bodies can be a key reason behind the failure of SEZ programmes. Often, weak government bodies with limited capacity regulate SEZ activity, whereas the zone regulator needs to cover a wide range of points of interaction between zone users and the Government. The regulator must have a deep understanding of the challenges investors face, how to measure success, and how to maintain a continuous dialogue without being overly influenced by business interests. The agency should work with relative autonomy from government and be staffed with highly competent individuals, many drawn from the private sector. However, agency activities should be monitored closely, by a cabinet-level official, perhaps with the technical support of an international organisation with competence in the area.

While giving the regulator the power to make and enforce decisions on most transactions between Government and zone residents – licensing, registration, customs, zoning, taxation – in most SEZ programmes, customs, environmental compliance, and immigration issues remain outside the authority of the regulator for political and practical reasons.

To ensure the necessary authority and autonomy, an effective arrangement could be to set up a memorandum of understanding across agencies.

13. PROVIDE EFFICIENT AND PROFESSIONAL ADMINISTRATIVE SERVICES

SEZ programmes should strive to provide efficient administrative services for zone residents, making business registration, licensing, and other administrative processes as accessible, predictable, and efficient as possible for zone tenants.

The regulator needs comprehensive authority to issue approvals, licences and permits, as well as facilitate infrastructure delivery. Typically, the regulator sets up an One-Stop Shop (OSS) – either directly or by delegating authority to the zone operator. OSS initiatives require extensive powers and implementation capacity, which is often lacking in developing countries, and this is often the explanation for OSS failure.

The regulator must maintain continuous dialogue with the private sector and understand the challenges investors face. Staff should be competent in a range of skills such as feasibility studies, finance, and familiarity with targeted sectors.

Should private investors become involved in zone development, the regulator will need substantial expertise in financial management and structuring complex PPP arrangements. This requires broad recruitment, so many regulators are outside the civil service system of their country, allowing them to pay market wages for the skills they need.

Good practice is to link the regulatory budget to zone revenues. While these can be significant, they are typically not enough to cover the full budget of a regulatory authority. Nevertheless, income from such sources can increase the political independence of the regulatory authority and increase financial flexibility.

14. SET UP PROPERLY DESIGNED ONE-STOP SHOPS

One of the most important functions of SEZs is to provide administrative services to investors. This is particularly important in countries with a legacy of a highly regulated economy, including many oil-exporting economies. The most common model is one-stop-shops (OSS), single administrative points for investors to request and receive all necessary authorisations for establishment and operations.

This can be a dedicated OSS established in another section of the public administration, or alternatively the SEZ regulator itself. OSSs in theory should expedite procedures for investors by bypassing or shortening normal government procedures. If well implemented, OSSs or empowered regulators shield investors from the regulatory burden found in the rest of the economy by streamlining approvals for permits and licences. OSSs can also provide information for investors by publishing statistics and market information. They can also be convenient hubs for arbitration knowledge. For example, in Dubai, companies reported that "developed infrastructure", an OSS and the availability of all documentation in English were the primary attractions of the SEZs.

All too often, however, OSSs add yet another layer of red tape for investors and increase the complexity of administration systems. This may be caused by a zone regulator that lacks the authority to issue or obtain permits and licences for investors. Unless the OSS is tied to a powerful regulator which has powers to grant necessary approvals or negotiate on behalf of the investor, OSSs can aggravate interagency and institutional conflict. In the worst case, this ineffectiveness can jeopardise the SEZ

OSS may handle a range of tasks, from company registration through to tax collection and monitoring environmental compliance. This requires not only substantial institutional capacities, but also a clear delegation of authority from relevant ministries, agencies, and local authorities. The back-end linkages must also be clear: if an OSS registers a company, the information has to be shared with the public agency responsible for company registration in the rest of the economy.

Chapter 4: Provision of necessary resources and building strong institutional capacities

This chapter highlights the need for transparent, predictable budget for zone regulation, development, and operation as well as for strong, appropriate institutional capacities that can steer the programme in the right direction and towards the pre-determined targets.

As for the budget, examples abound of zone authorities subject to unpredictable annual budget allocations, insufficient for the agency to provide the critical mass of services and incentives needed to attract and retain zone residents. As for institutional capacities, the zone programme has to develop a strategic long-term approach to developing human capital and solid operational processes, in particular as one single agency will often be expected to handle a wide range of functions requiring expertise, perhaps most importantly the ability to understand and analyse the technical, legal, social, and financial feasibility of a major zone investment. Many countries find that the modest wages, regulation, and seniority restrictions of the civil service constitute a hindrance to attracting talent and sanction recruitment on more amenable terms.

15. ENSURE PROFESSIONAL HUMAN RESOURCE MANAGEMENT AND ACCESSIBILITY OF SEZ

The regulator must have a deep understanding of the challenges investors face, how to measure success, and how to maintain a continuous dialogue without being overly influenced by business interests. The agency should work with relative autonomy from government and be staffed with highly competent individuals, many drawn from the private sector. However, agency activities should be monitored closely, by a cabinet-level official, perhaps with the technical support of an international organisation with competence in the area. Often, recruitment is handled outside the civil service system and related restrictions on hiring, remuneration, and promotions. Many countries set up the zone regulator as a corporatised agency for the purpose of circumventing such restrictions.

16. PROMOTE GOOD GOVERNANCE

Effective SEZ development requires substantial institutional capacity, which at times is difficult and costly to ensure in a highly regulated environment with multiple government failures. Some countries set up independent units in the pilot phase, with the freedom to make strategic decisions, recruit at competitive wages, and evaluate progress. This is, naturally, much easier than raising capacity in the administration overall. Apart from the zone regulator, other institutional support is important to SEZ success. Investment promotion agencies play a strong role in developing and emerging economies; they are often an essential facilitator in challenging business environments.

Chapter 5: Increase ASEAN SEZ co-operation and promotion

This chapter provides guidance for developing joint action at the ASEAN level. Such action could include minimising adverse effects of SEZ policies, promoting good-practice-based peer learning, harmonising the different regulatory frameworks, as well as co-operation on issues like zone connectivity, binational zones, and investment promotion and branding.

17. SUPPORT SEZ COOPERATION AND PROMOTION ACROSS ASEAN THROUGH POLICY INTERACTION AND EXPERIENCE DIALOGUES/SHARING

The establishment of a mechanism to carefully assess policy interaction at the regional level is important in view of the complex interaction between free-trade agreements and SEZs.

Paralleling the rapid development of SEZs has been that of regional trade agreements (RTA) – in 2010, 457 had been notified to the WTO. But RTAs often face challenges in incorporating SEZs into their regulatory frameworks. One novel approach has been SEZ cooperation. In 1993, Indonesia, Malaysia, and Thailand launched a transnational export processing zone, allowing companies to exploit comparative advantages in several countries. Apart from joint development of infrastructure, the initiative attempted to harmonise investment law, taxation, land allocation, labour codes, and customs. Such cooperation can support the AEC objective of facilitating an integrated production base.

18. EXPLORE ASEAN CO-OPERATION ON ZONE CONNECTIVITY, PARTICULARLY FOR ZONES IN BORDER REGIONS ENGAGED IN STRONG SUB-REGIONAL TRADE.

Furthermore, in parallel to regional integration initiatives, such as trade agreements, many developing countries and their donors are placing vast resources on transportation infrastructure to connect regional producers to markets. Developing these regional industrial linkages through SEZs also make sense in this context, if countries wish to leverage the improved transport corridors that allow smoother and more cost-effective logistics within the region.