



## A Note On Export Processing Zones: The Bangladesh Case

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### 1. INTRODUCTION

The Concept of Export Processing Zone (EPZ) is not new today. It is a special case of 'Free Trade Zone' which combines trade and manufacturing activities of a country. According to the United Nations Industrial Development Organization (UNIDO), the concept of EPZ implies 'the establishment of modern manufacturing plants inside a customs-bonded industrial estate by offering a suitable package of investment incentives to both foreign and domestic entrepreneurs'. The central idea of EPZ is to provide incentives for investment, especially to motivate multinational corporations or companies to use the Zone as a low cost production base for labour intensive components, such as manufacturing, assembling and middle-stage processing for export to home markets or to other world markets. The emphasis obviously is not on the development of domestic manufacturing capability as such, but on the role of multinational companies for processing for export. Therefore, essentially "an EPZ is a foreign enclave with obvious extra territoriality in decision-making by units located in the Zone".

In the whole process the search for low-cost labour is the main motivation of foreign investment and further that multinational firms can be induced through incentives to locate their labour intensive stages of production in the EPZs of developing countries. The incentive scheme is critical for it is what makes the production operation relatively cheap in the Zone as compared to domestic tariff areas. In general, the incentive scheme includes duty-free import of capital goods, raw materials, components, spares, tools and other inputs. In addition, there are incentives in the form of tax concessions, both direct and indirect, at least for some initial years; finance at concessional rates of interest; power and infrastructure facilities at reduced rates, etc.

The Export Processing Zone is normally located near a major port and in proximity to an assured supply of labour in order to reduce the transportation costs. The basic thrust of the incentive scheme is to make export development on a meaningful scale by correcting the distortions in the domestic tariff areas. Probably the same objective can be achieved through incentives (e.g. duty draw back, export subsidies, etc.) within the domestic tariff area itself, but the presumption is that the objectives can be achieved more effectively in the EPZ. Usually EPZ can be of three types:

- i) Manufacturing
- ii) Warehousing and
- iii) Combination of both.



The EPZs of Bangladesh are of manufacturing type. About 850 Export Processing Zones or Tax Free Zones or Free ports of the world enable manufacturers, Assembler importers or exporters to benefit from a variety of customs privileged facilities by offering them guarantees, incentives and other advantages. Region wise North America has 320 EPZs, Central America 42, South America 41, Europe 81, Africa 47 and Asia and the Pacific 275. The United States has the maximum number of 213 EPZs, followed by China with 123 and Mexico 108. By seeking the sheltered areas best suited to their needs, components engaged in processing and assembling can save on taxes and many other costs including transportation expenses, plant rentals and excess wages of labour, which is the single most important factor for cutting production cost.

From the very beginning, the EPZ has been considering one of the most important administrative instruments for providing free trade status to manufactured exports. The importance of EPZ can be regarded as a policy instrument tends to diminish an economy in order to be successful in its out world-oriented strategy. Developing economics seeking to enter or expand manufactured exports require adequate physical trade infrastructure and a legal and regulatory environment favourable to private business and exporting industries.

## **2. THE HISTORY OF EXPORT PROCESSING ZONE**

The history of Export Processing Zone dates back several hundred years. Historically, a tool for aggressive commercial power, the EPZ dates back to the time of ancient Phoenicians, when safe passage was the chief guarantee offered to foreign traders visiting tire (now in Lebanon) and cartage, a pre-mediaeval city in the Mediterranean belt. Later, the idea was adopted by the Greeks and then by the Romans, who developed these into launching pads for economic and political domination's. The EPZs also proved their worth by helping to enrich members of the Hanseatic League (During that time Hanseatic was in north of Germany). In the mediaeval age, King Alfred, the Great of England introduced the concept of Export Processing Zone in his country. In 898, King Alfred guaranteed the Archbishop of Canterbury, the right to anchor ships at Queenhithe in London without paying normal customs duties and royal tax (during that time, income tax was known as royal tax in England). Many other governments took up the idea of extending Export Processing Zone facilities, from the year 1009. One early example that resembles the zones of today was the Steelyard in the city of London. That was a special part of the port near London reserved for businessmen from the cities of north Germany. They were exempted from paying customs duties on goods passing through the Steelyard. In those days one had to pay customs duties on export not on imports. The modern era of Export Processing Zone began with the United States establishing its first Export Processing Zone in 1930. But the Shannon Free Zone of the Eire is considered as the model of modern export processing zone. The Gibraltar Export Processing Zone is the oldest among the operating EPZs of the world Gibraltar established its EPZ in 1705. In Asia, the Macao Free Zone is the oldest. It has been operational since 1829. The Macao Free Zone mainly produces garments, furniture, rubber goods, toys and novelty items. Taiwan took the process a step further with the establishment of a science part at Hsinche, which aims to shift the emphasis of investment away from labour-intensive assembly industries, towards advanced technology.

An Export Processing Zone or a Free Trade Zone can help alleviate some development problems. It can help earn foreign exchange, generate employment, expedite technical exchange and regional development. Export Processing Zones or Free Trade Zones can be a gateway to development for many countries. The zone can be a seed, which falls on a fertile ground, and build strong roots and spread their branches over the rest of the economy. In many countries, political and business leaders see the success of a less regulated environment and it spreads into the domestic economy until the domestic economy and the EPZ have very similar regulations. This has happened in South Korea and China. The EPZs of these countries have been very successful. After 1990, the EPZs of these countries have been working as the most stable source of foreign exchange earning than the minerals or oil. Successful zones are not passive recipients of investment. Successful zones are active participants in the decision process that investors make to locate their factories in their zones. This is an important principle. Successful EPZs have developed promotional programs that influence the decision of some of the largest corporation of the world.



### **3. FACTORS OF EXPORT PROCESSING ZONE**

Location is the most crucial factor for the success of an Export Processing Zone. Any investor investing in a zone will definitely want to reduce the cost of transportation in both ways i.e., for export of goods produced and import of raw materials. Another factor is political stability. With investors making a long-term commitment. The political situation is vital and they are naturally more worried about this than exporters would be. Whether the host country has preferential access to potential world markets such as the European Union (EU) or the Association for South East Asian Nations (ASEAN) or the United States is highly important. Labour cost is clearly a major attraction. However, comparative differences between individual developing countries seem to matter much less than the basic cost differences between a western country and third world in general. Productivity levels do influence investors. Transport and communication links are also vital. If a zone is not within reach of the right markets, it will be critically weaker. Other important factors include infrastructure, reliable utility services e.g., water, power, gas, telecommunication etc. land prices, supply of manpower transport links, communication network and environment. Although the description of Export Processing Zone varies, the range of concessions are broadly the same; freedom from customs duties and export/import taxes. Generally, all facilities allow entry of raw materials, components and finished goods of foreign origin and subsequent re-export without being subjected to customs duties. In many zones, foreign traders may hire warehouse, manufactures and package goods without the host country applying its tariffs or import controls on the merchandise in the zone. Normally, customs duties are levied and import controls are applied only when the foreign goods are removed from an export-processing zone for use or consumption in the country where it is located.

A Free Port usually encompasses an entire port and surrounding areas. In some cases, Free Port customs privileges may apply to the entire territory like Hong Kong. As a rule, foreign goods may be introduced into Free Ports without being subject to customs duties. There are a few restrictions governing entry handling, processing and re-exporting of goods, making Free Ports the most flexible form of customs privileged facilities. In recent years, some countries operating Free ports have imposed tariffs or local taxes on an increasing number of imports. In some cases adverse economic or exchange conditions have forced the authorities to curtail certain Free Port functions, including processing and manufacturing. Located half way between Europe and the far-East, Bangladesh is rapidly developing into a center of activities for export oriented international manufactures. With its privileged location on the Bay of Bengal, Bangladesh is attracting the attention of the global manufacturers. The entrepreneurs are attaching utmost importance to Bangladesh because of the country's close proximity to the fast growing ASEAN markets and the fact that she is within easy reach of the Middle East. Another important aspect is the availability of the most inexpensive and productive labour force, which has aptly dubbed the EPZs of Bangladesh as the optimum profit earning bases of the World. Prospects are further boosted by the fact that the Government of Bangladesh has been pursuing a most liberal policy for foreign investment. As a part of this policy, the role of the government today is promotional rather than regularity. Location is one of the most important factors for the success of an Export Processing Zone. The other factors may include (i) Local labour supply (both skilled and unskilled), (ii) Proximity to international sea and air ports, (iii) Accessibility of the global markets, (iv) Adequate supply of various utility facilities like power, water, gas and telecommunications, (v) Suitable living accommodation and educational facilities for foreign investors and their dependents and (vi) Weather conditions.

### **4. LINK OF EXPORT PROCESSING ZONE WITH THE LOCAL ECONOMY**

At the early stage when Export Processing Zone was established it was expected that production and sales of local raw materials and semi-furnished goods would gradually increase. But we get very discouraging results from Malaysia, Philippine and Mexico. There is, however, a complain that the local products are unreliable and of low quality. A very few number of local suppliers could do well, especially electric firms. The zone contributes significantly to the employment of unskilled and semi-skilled workers. And this discourages the people to go overseas for job.

### **5. THE EXPORT PROCESSING ZONES IN BANGLADESH**



The main idea behind setting up of export processing zones in Bangladesh was to ameliorate the suffering of the common people by accelerating the process of industrialization. In a country like Bangladesh, capital formation is very low and technological facilities are very limited. Thus, foreign investment can play a catalytic role in promoting economic development of the country. Much has been said about the failure of industrialization based on inward orientation, which in the sixties, held sway in almost all the developing countries to overcome under development. Bangladesh conceived the idea of establishing EPZs in the mid 70's. However, the first EPZ of the country, the Chittagong Export Processing Zone (CEPZ) started functioning in 1983. The second Export Processing Zone in Bangladesh is the Dhaka Export Processing Zone (DEPZ) started its functioning in 1993. The Khulna Export Processing Zone (KEPZ) is the third Export Processing Zone in Bangladesh is under construction. Government has taken decision to establish the fourth Export Processing Zone in Ishurdi last year and at present it is under implementation stage.

Bangladesh Export Processing Zones authority extends ten years tax holiday for all types of investments. It also exempts income tax on interest on borrowed capital, income tax on the sculleries of foreign technicians for three years subject to certain conditions, divided tax for holiday period and customs duties and sales tax on imported motor vehicles for the executives of enterprises in the zones. Bangladesh EPZ authority permits duty free import of machinery equipment and raw materials and duty free export of goods produced in the zones. The other incentives and facilities provided by Bangladesh EPZ authority include fully serviced and developed industrial plots for immediate construction of factory buildings, liberal employment of foreign technical, freedom from national import policy restrictions, relocation of existing industries from abroad, back-to-back LC facilities for certain types of industries for the import of raw materials, off-shore banking felicities, import of raw materials on a Documentary Acceptance (DA) basis and equal rights for foreign employees on a similar basis to Bangladesh nationals.

## 6. PATTERN OF INVESTMENTS IN THE EPZS OF BANGLADESH

Three types of investments are allowed in the EPZ's of Bangladesh. They are 100% foreign ownership including ownership by Bangladeshi nationals residing abroad; joint venture projects between foreign and Bangladeshi entrepreneurs residing in Bangladesh, and 100% Bangladeshi entrepreneurs residing in Bangladesh. In the EPZs of Bangladesh foreign private investment can be made either independently or through joint ventures on mutually beneficial terms and conditions. For example, at present in the Dhaka Export Processing Zone, 76.9% of the total investment is due to foreign investment, 14.3% investment is due to joint venture projects between foreign and Bangladeshi entrepreneurs and the remaining 8.8% of the total investment is due to Bangladeshi entrepreneurs. The percentage distribution of investment according to different countries is as follows:

Table 1: Country wise investment in DEPZ

Countries	Percentage of Investment
South Korea	35.1
Germany	1.7
Japan	20.6
Pakistan	1.0
Honkong	15.8
Bangladesh	14.3
USA	5.8
Others	5.8



However, investors have also option to establish either public or private limited companies or sole proprietorship or partnership concerns. An approximate list of industries in EPZs in Bangladesh include Electric equipment and components, Electronic products, Software Optical goods, Woven and knitted fabrics, Engineering products, Leather products, Foot-wear, Toys, Medical and Biological instrument, Pharmaceutical products, Plastic molded products, Industries based on new uses of jute, Cutting/ polishing of precious and semi-precious stones, Household fittings and equipment, Specialized garments, Headwear, Jewelry, Horological instruments, Scientific measuring instrument, Aircraft instruments, Laboratory ware, Printing and publishing, Printing and copying equipment and accessories, Musical instrument, Products based on laser technology.

### **7. Legal Aid from the Government for the Investors**

All investments in the EPZs are secured by a parliamentary Act. The act also ensures fair and equitable treatment to foreign private investment. Under the act, foreign investment in Bangladesh can neither be expropriated nor nationalized. It also guarantees full repatriation of profits and capital. A number of international organizations like Multilateral Investment Guarantee Agency (MIGA), International Center for the Settlement of Industrial Disputes (ICSID) and the Overseas Private Investment Corporation (OPIC) of the USA also ensure investment guarantee for investors in Export Processing Zones. MIGA is the newest member of the World Bank group to help foreign investors and host countries, while ICSID extends facilities and OPIC operates its insurance and finance programmes in the Export Processing Zones.

### **8. The Bangladesh Export Processing Zone Authority**

In order to ensure smooth running of the Bangladesh EPZs, a two-tier administrative set-up has been adopted. They are a Board of Governors and an Executive Board. The policy making body of the Bangladesh Export Processing Zone Authority is its Board of Governors headed by the Head of the Government i.e. the Prime Minister of Bangladesh. It consists of a number of Ministers and Secretaries of the Government. The board also includes the Governor of the Bangladesh Bank, the Executive Chairman of the Board of Investment and the Executive Chairmen of Bangladesh Export Processing Zone Authority. The Executive Board is mainly responsible to implement the decisions of the Board of Governors. The Executive Board is also responsible for efficient management of Export Processing Zones. Entrepreneurs are not required to deal with any other agency but the Bangladesh Export Processing Authority. They get their approval to establish industries in the EPZs of Bangladesh Expediently. Rules, regulations, import-export documentation and procedures have been brought under a single system.

### **9. CONCLUSION**

Bangladesh is one of the most populous (8<sup>th</sup> position) country having dynamic population growth rate (2.7 percent) in the World. As an under developed economy, Bangladesh has a large number of illiterate (55.2 percent) people with labour force growth at 3 percent per annum only, by absorbing the additional workforce in every low level occupations in the informal sector. It is currently estimated that the labour force is growing at almost twice the rate of population growth. Decelerating population growth is being more than offset by increased participation rates, especially of women whose social role and greater education are changing and widening their horizons. Even though their entry into the labour market will be particularly offset by higher secondary-school enrollment by youngsters aged 15-19, the job market will still have to bring into being over two million jobs a year to employ new entrants and lower open unemployment down to 10 percent by 2020. In order to achieve a substantial reduction in underemployment as well, Bangladesh needs to create over 50 million jobs during the next 25 years. The employment generating potential of industry (large-scale, small-scale and rural) could add 2 to 2.25 million manufacturing jobs every five years until 2010 and close to 3 million thereafter in the industrial sector and in this situation the implementation of new EPZs and expansion of the existing EPZs are crucial. Dhaka Export Processing Zone has already started creating new opportunities for employment through its extended wing. The major portion (60 percent) of the workers and employees are from the locality around the DEPZ specifically from



Savar and Dhamrai Thanas. It is observed that a very different life style has already adopted by the employees which is very clear from their clothing habits, change in pattern of recreation and other parameters that are related to life style.

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