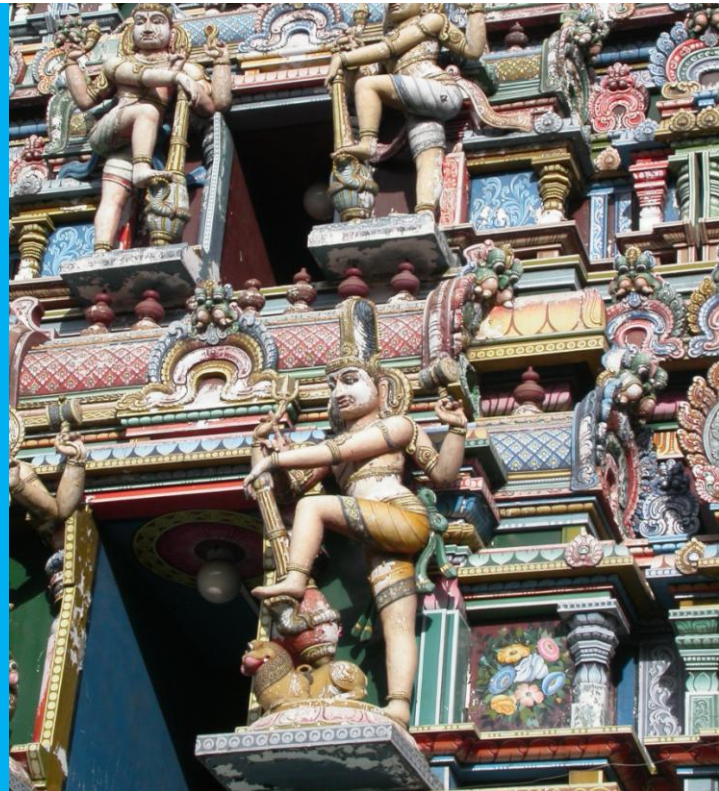




Impact of EPZs on poverty reduction and trade facilitation in Sri Lanka



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Abstract:

Export Processing Zones (EPZs) have been among the primary factors of export-oriented growth in recent decades. EPZs first came about in 1959 with the establishment of the Shannon Zone in Ireland. Following that, the first few zones were envisaged primarily as industrial zones that were to attract foreign investors to set up facilities to process imported materials and subsequently export their products. With regard to trade facilitation, it is clear that EPZs offer some important advantages. Through simplification of customs procedures that reduce the number of steps and documents needed when processing imports and exports, thereby cutting down on the amount of time taken to process these goods, EPZs have had a significant impact on facilitating trade. This is particularly the case with goods being delivered by sea. Furthermore, operating within an EPZ allows firms to take advantage of backward and forward linkages available in the zone. Manufacturers in the garment industry, for example, can source from suppliers of yarn and thread processing plants within the same EPZ and further down the supply chain, and they can link up with washing plants that create finishes for articles of clothing, also within the EPZs. These are opportunities that are rarely available for companies that operate outside these zones.

JEL Classification: F1**Key words:** Sri Lanka, Trade facilitation, Export Processing Zones

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Introduction

Export Processing Zones (EPZs) have been among the primary factors of export-oriented growth in recent decades. EPZs first came about in 1959 with the establishment of the Shannon Zone in Ireland. Following that, the first few zones were envisaged primarily as industrial zones that were to attract foreign investors to set up facilities to process imported materials and subsequently export their products. In the 1970s, EPZs were seen as playing one of the most important roles, with regard to employment strategies, that promoted export-oriented foreign investment. By 1997, 27 million workers were employed in more than 800 EPZs across the world.

The primary aims of an EPZ are manifold. They include generating employment, expanding the exports industry, attracting foreign exchange, encouraging technology transfer, improving human capital, developing backward and forward linkages, and promoting economic development in less-developed regions within a country (Thamarajakshi, 2001).

An EPZ is defined as a geographical area housing export-oriented manufacturing facilities or service enterprises. These zones may be located anywhere in a country and, in many cases, are situated in close proximity to ports and/or harbours to enable ease of access to shipping lines and freight forwarding services. Firms operating within EPZs usually benefit from special incentives aimed at promoting investment, with customs duty exemptions and tax incentives among the most common. They may be labelled under different names around the world, such as “enterprises” in Honduras, “special economic zones” in China and “special export processing zones” in the Philippines (Thamarajakshi, 2001).

The key objectives of EPZs – increasing exports and foreign exchange earnings, attracting foreign direct investment (FDI), diversifying exports and creating jobs – can, in turn, have a significant bearing on facilitating the trading process as well as alleviating poverty in an economy. For example, with the objective of boosting exports, EPZs could implement policies to simplify the export procedure. In addition, the need to attract FDI would necessitate improving the business (and trading) environment in the country; infrastructure development that accompanies many EPZ development schemes would, in turn, lead to a smoother and faster trading process. The establishment of zones in rural areas that promote infrastructure and industrial upgrading in such areas could enhance economic opportunities for the poor while employment generation, especially for the population in rural areas with low skill levels, could also play a key role in alleviating poverty.

It is well established that international trade plays a key role in acting as an engine of growth and poverty reduction in developing countries. While Sri Lanka initiated the process of trade liberalization in South Asia, other barriers such as administrative and technical barriers have become an increasingly significant impediment to trade. In order to promote export competitiveness in Sri Lanka, it is essential to remove such barriers. One way of doing so, and thereby facilitate trade, is through EPZs that provide customs-free and tax-exempt, export-oriented manufacturing facilities, investment incentives and streamlined administration, cheap utilities and better infrastructure. Trade facilitation may be the quintessential purpose of these zones, but another important aspect of EPZs is their potential to alleviate poverty.

The existing literature on EPZs in Sri Lanka mainly discusses the impact of trade and investment incentives on export performance, and the relationship between EPZs and employment generation (Sivananthiran, 2008). However, there has been limited quantitative analysis comparing firms that operate within EPZs and those that are located outside these zones, particularly with regard to assessing the livelihoods of employees and evaluating the impacts of trade facilitation for firms within these zones.

In this context, the study detailed in this chapter was aimed at conducting a comprehensive evaluation of the effectiveness of EPZs on poverty reduction as well as provide an analysis of these zones as a mechanism of trade facilitation through such processes as simplification of customs procedures, streamlined administration and socio-economic welfare in the immediate surroundings of these zones. The study also took into account the effect of EPZs on employment generation, education and specialized training among the poor in these areas.

2. Literature review

2.1. Overview

Tantri and Kumar, 2011) identified some specific means through which EPZs could promote trade facilitation levels in a country, primarily by reducing the time required for doing business and a reduction in associated transactions costs within EPZs.

Sri Lanka's first EPZ was established in 1978 at Katunayake as a part of the economic liberalization policy that was introduced following decades of protectionism. The setting up of EPZs was seen as a means of attracting FDI into the country. Sri Lankan zones provided modern infrastructure, a wide range of services and generous economic concessions to

foreign investors. The zones were expected to absorb labour from the urban and suburban districts around the capital and in areas with high levels of unemployment.

The Board of Investment (BOI) is the apex EPZ authority and has its origins in the Greater Colombo Economic Commission. Following the establishment of the Katunayake zone, BOI became involved in a massive expansion in EPZ schemes and has established 12 economic zones in the country since 1978, including nine EPZs, two industrial parks, and one export processing park (Board of Investment of Sri Lanka, March 2012) (table 1).

Table 1. Export processing zones in Sri Lanka, 2012

Location	Number of enterprises	Year established
Mirijjawila Industrial Park ^{a,b}	3	-
Katunayake Export Processing Zone	86	1978
Biyagama Export Processing Zone	58	1985
Koggala Export Processing Zone	20	1991
Kandy Industrial Park ^b	21	1994
Wathupitiwala Export Processing Zone	17	1998
Mirigama Export Processing Zone	6	1998
Malwatta Export Processing Park ^b	4	1998
Seethawake Export Processing Zone	30	1999
Horana Export Processing Zone	12	1999
Mawathagama Export Processing Zone	7	2000

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