

GLOBAL TRADE DEVELOPMENT WEEK: 4TH GLOBAL FREE TRADE AND SEZ SUMMIT, KUALA LAMPUR, MALAYSIA, 31 MARCH TO 2ND APRIL 2014

Attended by Ajiv Maharaj

The summit highlighted the growing number of SEZs and free trade zones which are proliferating the world economy. Many countries are developing SEZs to stimulate inward investment, attract foreign companies, increase economic growth and create jobs. Importantly it was noted that such zones attempt to address inconsistencies and inefficiencies in the trade system. What is the need for SEZ? The very existence of such zones highlights the fact that the trade environment in many countries is inefficient and often not conducive to a well-functioning and competitive trading system. These inefficiencies are in themselves difficult and too complex to address in their totality, however, the creation of pockets of excellence allows for well-functioning areas which are capable of attracting and retaining companies that add value to the economy.

It was further highlighted that in China specifically, which has been a pioneer and forerunner in the field of free trade and SEZs, this concept has been used as pilots that test specific concepts, practices and to observe its impact and effectiveness. In cases where highly positive impacts have been observed and in so far as is feasible, China has further went onto to build such practices into the overall system to make the production and trade environment generally in the country, more competitive. Thus in this instance the SEZ area has been used as a kind of laboratory which has fostered innovations.

Complexity in World Trade

Dr Jayanth Menon ADB.

This presentation emphasized that the SEZs are trying to get us out of inconsistencies in the world trade system. There several agreements with World Trade Organization. The BALI Trade Agreements and sectoral agreements were a move in right direction, but the original DOHA round has gone and there are many smaller agreements proliferating the world trading system. There is now a proliferation of bi-lateral FDAs. This has led to a complex and messy world trade system. What can we do to reduce the complexity in world trade? The move towards mega-regionals is a step in the right direction. The Transpacific partnership involves 4 countries consisting of Singapore, Malaysia, Vietnam, etc. Another regional involves Japan and Taiwan. The role of the WTO is still relevant as it should still play a leadership role and dispute settlements and sectoral agreements, but need more, need counties to go further often unilaterally. 60% of trade liberalization has been done counties not requiring reciprocity but based on their own self-interest. Need to now reconsider unilateral trade agreements and do away with distortions and multiple requirements. Unilateral reforms involving the multilateralism are preferences.

Youth and Skills Development

ILO: Jose Manuel Salazar.

The issue of Youth unemployment and skills mismatch was identified and discussed. There were links drawn to skills development and trade productivity and performance. The skills in demand in the 21st century have shifted from industrial to information based economies, just as change from agrarian to industrial happened before. There are broadly 4 Groups:

- 1. Creativity, decision making and innovation
- 2. Existing Ways of working
- 3. New ways of working
- 4. Skills for living in the world

There are major disconnects between place of study and work, between education and work, also between research and workplace, and between different places of study. This is the most severe among lowest income countries. The business sector also has responsibility, as traditional systems can't deliver the skills they need. Prospective workers can't be job ready without on the job training, and they can't wait at the end of the training pipeline. These gaps are common around the world. Porter calls it the share value approach. ILO also does skills forecasting and look at future skills e.g. G20 skills strategy for sustainable growth. Skills for trade and economic diversification (STED) looks to the future and identifies gaps and how to address gaps with employers. STED pilots in Bangladesh, etc. Have been very useful and worth reading up on. Apprenticeships are a major good value proposition for both companies and the youth. Employer investments in it are paid back on average in 3 years. Recent initiatives, e.g. Business 20 and Labour 20 groups are useful examples to look at. The European Alliance on apprenticeships and Global Apprenticeships are worth looking at and the ILO is closely involved on all of these. Read more on www.globalapprenticeships.org

Location and Site Specific Characteristics

Office site selection often uses the supply chain perspective. However, real estate does not play a lead role, as the strategic objectives come first, while real estate considerations come next. The cost of real estate should be a smaller percentage than the investment you are putting into the investment. Transportation costs are also an important consideration. Distribution centres are now part of supply chain process. However, the lack of suitable real estate can be a barrier to investment as is the case with a lack of planning. The preference is for ready-made estates and ease of development plays an important perspective in ensuring that this supply is met. The role of the local authorities in facilitating the investment is important and directly affects the ease and cost of setting up. In cases where there is land scarcity, the distribution centres are pushed out. It should be noted that the most important incentive that the local authority can provide is the PRE-approval of land for development and SEZs play an important role in that.

Geographically, energy demand and growth is important due to the fact that the initial cost is high, but the most important factor is to look at a location where the business can grow over the next 20 years. There must be laws in place to protect the investment. There is also a proactive role for local authority to play in getting land ready. Consistent delivery of the zone and maintenance of the zone is important as it needs to continue to improve itself and provide new potential opportunities.

There is a trend towards the rental of land, particularly in Rotterdam and some other port areas, some companies took too much land more than they need and as a result the city is running out of land. Are we going into a system where regional authorities are trying to control the use of land. A factory in one location may move after 10years if price factors increase. The trend is towards short term lease as business is becoming more dynamic. Developers not looking at locking capital in free hold ownership for long term. The key thing is flexibility and ability to react to economic the environment. 5 or 10 year lease is the norm, while you need long term assurity, but it must be able to accommodate changing investment environment.

In Malaysia there is a proposal to build green zone within the northern economic corridor which has been identified. The government wants to ensure investment in that corridor, and business developing zone into that broader zone.

Unilever rep made input on location: when SEZs are set up on political grounds e.g. in rural areas, Unilever doesn't want to be the first mover, there must be activities already started, and commitment

from the economic agencies. Some proposals like building a new port, is long term so can't make decisions on that unless it's happening. Incentives can play a decisive role in getting company to say yes or no. In rural areas, the concerns are about the reliability of service. There are a number of non-financial incentives such as housing, talent/skills, etc. as well as energy and clean and green energy is important for business, and utilities are very important. Those things are more important than 1 or 2 year incentives in rental. It has been shown that the best, highest method of reducing carbon production is through green energy use and reduction of energy, so energy is the biggest sector contributing to carbon production. It is also important when attracting corporate head offices.

Customs and Illicit Trade

DANIEL HUBERT

The Tabaco Producers Association, has introduced sophisticated and high technology mechanisms for the tracking and tracing of products using technology to exclude illegal Tabaco trade. The industry contributes \$150bn in taxes a year. Illicit trade accounts for 12% of trade and is excluded from that and is illegal. For tax purposes, need system that looks at manufacture, distribution, market and enforcement, so considers the full supply chain.

There is a danger that when you streamline processes and removes red tape which SEZ does, then illicit trade can flourish. What does WTO say about unfair trade through SEZs?

Single windows: Unilateral agreements - have to trace place of origin which is sometimes costly and complex especially when you have multiple FTAs.

Export/ World Trade in Relation to GDP

Dr Marc Auboin: WTO

Has international trade lost its motor? Is there a slowdown of globalization after financial crises?

Exports in relation to GDP need to be looked at. While the levels of growth are very different to the pre-crises level, international trade continues to grow faster than GDP. In 1990s there was move to trade liberalization and hence there was rapid growth in global trade but this was never going to be sustained and it had to settle down. More recently looking at crises, there is a cycle and world follows similar pattern of growth and upturns and downturns. International trade is pro cyclical to international GDP, mainly because of manufactured good. Services sectors have been growing and have become very large. In addition there giants/mega trading blocs e.g. European Union which affects international trade. US economy has been growing now and EU is also growing although slower. Big area of trade that has seen significant trade is the south-south trade and intra-Asia trade growth. Over the long term it is clear that the major growth in world trade has been in the Europe -Asia trade route.

LEE TATT BOON: International chamber of Business

Post Bali trade agenda to generate growth and jobs.

RTAs (Regional Trade Agreements) and PTAs (Preferential Trade Agreements). Regional trade agreements (RTAs) have become increasingly prevalent since the early 1990s. As of 31 January 2014, some 583 notifications of RTAs (counting goods, services and accessions separately) had been received by the GATT/WTO. Of these, 377 were in force. What all RTAs in the WTO have in common is that they are reciprocal trade agreements between two or more partners. The WTO also receives notifications from WTO members regarding preferential trade arrangements (PTAs). In the WTO, PTAs are unilateral trade preferences. Small business finds it difficult to participate in terms of both of these trade agreements and the often favour larger enterprises. There is a need to increase the capacity of the WTO to

monitor and put general agreements on trade and best practice guidelines and have standard rules of origin and transparency mechanisms for RTAs and PTAs. Cross border investment generates revenues and jobs, and links local companies to global trade. Over 3000 trade agreements exist and this covers 2/3rds of investment. Another 14000 are needed to protect investment. Things like OECD breaks down these systems of trade and promotes more global trade.

The ASEAN Economies

ASEAN community 2015

In terms of the cost of trade the ASEAN countries are close to the benchmark, while in east Asia the cost of trade has come down this is not so in the ASEAN countries. To what extent will the formation of this community bring down costs and promote free movement of goods, etc. What has been the track record in making ASEAN vision a reality and regional integration. There has been an increase in transportation infrastructure developed to promote economic corridor development and integration. The north south corridor has many SEZ developed and linking china to Vietnam. China, Vietnam, Cambodia and Myanmar signed cross border agreement but there are not functioning well. The cost of logistics is still high, transport by road still considered more efficient and other forms not working as well as it should. There are difficulties in attracting investment in SEZs e.g. in Cambodia the SEZs were very FDI orientated, but when you do that there is a lot of challenges. In addition to infrastructure, also need finance and skilled people to make SEZs work. Some countries, return shipment containers must be empty due to the customs rules. However it is starting to change as that practice makes shipping more costly.

Logistics links are important as well as good services like electricity. Industrial estates connected to the local economy are particularly beneficial. The mature industrial estates must support agglomeration economies. SEZs play a role in connecting into global economy- at first the general policy environment was bad, and SEZ was experiment, at relaxing these rules and streamlining tax regimes and processes. However, eventually the general investment environment has been getting better and lessons, both good and bad have been learnt. Eventually these SEZs will be just industrial estates which provide access to real estate and promote innovation.

Two industrial estates one by local government and another by private Singapore company - promoting competition was briefly examined.

Regional trade agreements and their role in fragmenting the trading environment - does SEZ further fragment international trading systems? At one level SEZ is a refuge from high trading rules and inside its more simple and clear with no overlaps. Fragmentation depends on how it integrates with local economy, not a race to the bottom but a race to top where the rest of the economy becomes more like an SEZ, rather than the SEZ becoming more isolated and an island of differing rules and insolated economy.

RIO + 20 talks on sustainability brought a focus on including environmental sustainability onto the agenda of trade, but also it included economic and socially inclusivity. How sustainable are the zones? Before it was a case of dirty industries taking refuge in these zones e.g. these concerns were raised in Indonesia. Socially, we have seen SEZs promoting labour intensive growth, but we have also seen the rise in wages in China. However we can't only rely on SEZs to attract investment and promote trade. Other policy setting and investments in skills, etc. need to compliment the process. There is also the middle income trap – we see countries like Malaysia have become victims of their own success so it's

now having difficulty in moving up. Unemployed in Malaysia have tertiary education, but mismatch of skills.

Incentives: rather than tax holiday, have lower corporate tax as this is more sustainable. Incentives only matter when all the other more important issues are there, only to give slight edge. It is important to note that in China, SEZs were about experimenting, now e.g. whole of Shanghai is Free port area, and they experiment with other things as well. So we must learn lessons from SEZs which we can then apply in the wider economy.

SOME CASES

1. Aqaba Special Economic Zone: Jordan

Prof Kameil O Mahadin of Jordan: Aqaba Special Economic Zone. This SEZ has placed significant emphasis on spontaneous and expedient decision making. It has a stable political leadership and had millions coming in from Arab countries due to war. It is tax free for foreign investment and has well developed infrastructure. Aqaba is full SEZ and has free trade agreements with a number of other cities- so it promotes city to city trade. It takes just 3 days to register a company in this city and decision making is quick while red tape is minimized. Aqaba is the Hub of central Middle East.

2. Ras. Al Khaimah: UAE

PETER SPORT

Three key terms: connectivity, stability and pause-ability?

UAE has no taxes of any kind, no paye, vat, etc. so it is a great place to invest as a whole – however, there SEZs have built infrastructure are and ready to occupy.

Ras Al Khaimah (RAK) was fishing village run by one of ruling families (1 of the emirates in 7UAE) of the UAE. It then began to focus on cement and ceramics, and now it is tourism SEZ. The Hilton group saw potential and took the decision to build a major resort, and said that people will come, and made huge investment. It turned into a success and now they have many developments. Apartments and hotels have been built here and it is fast growing. Engineering services have been complete, there are no tax, ease of setting up business and ensuring facilities are available, etc., have made this area an investors dream. Ras Al K has 5 sea ports which are all privately run. Infrastructure connectivity is very good and there is a lot investment being made into infrastructure. Dubai international airport has become the second biggest freight airport in the world and will soon be biggest airport in the world. And RAK has very good access to it. RAK is also 25% lower than other free zones in UAE, including leasing land, labour, also access to recreation, entertainment, etc.

Trade Finance

SME finance for pre and post export finance. Banks don't look at purchasing order as enough security for lending. That is a market failure. IFC works in OECD countries and works with the large companies and local banks in emerging markets to provide guarantee for them to provide finance. But IFC only provides guarantee on post shipped goods so it is also risk averse, but still provides some security. Big companies will generally deal with a big company in emerging market, but dealing with SME is not preferred.

Islamic bank' ITFC - rather than cash flow look at other aspects, like product flow and demand and the like e.g. orders for coffee is the asset itself so lend and pay out on that basis. Another issue is the capacity of SME to apply for finance and international trade expertise as they don't have lots of different departments with expertise. Here ITFC comes in and assists the SME with expertise and training. Underlining product is taken as collateral by other banks like Citibank. Various other models as well,

they look at value every month of business and then provide and advance. 80% of the \$25trillion of trade is financed by lending. ECA: Export Credit Agency is a useful tool to assist SMEs in exporting. What is the South African trade finance regime? Do we have an export credit agency or are these global agencies. What is important though is the countries credit rating as these affect lending. The point made is that the largest global banks have stricter rules imposed on them because if they fail they will have global impact, so opportunity for smaller more regional banks to play a bigger role in specific areas. In trade finance, international community takes comfort in knowing that an SME that's located in SEZ, especially one like RAK has gone through due diligence and rigorous finances assessment – hence as an SEZ, RAK is able to ensure that local SMEs get access to global trade environment and are able to interact with global companies. There is also an opportunity for global banks to seek out business in free trade zones.

Human Capital – Notes on Panel Discussion

Jordan, no oil or industrial base, but human capital has been its most important asset, has invested heavily in that.

Korea: lots of doctoral science and technology students leave for USA and most of those that go there to study don't come back. This is a concern for the country and there is a need to improve research environment. SME have difficulties in accessing global market due to talent. The ratio of SMEs contribution to economy has decreased. Korean government has increased scholarship programme and research fellowships and science institutes are being used to keep talent and to attract overseas students.

ISKANDA Malaysia: supply and demand perspective. First developed a plan, then developed the human capital plan to develop in tandem. Investor, training institution and people, are the 3 most important things. IBM also spoke about supply and demand perspective. Singapore is now focused on attracting Research and Development to make that area a capital for knowledge and research. IBM started its 'Think Friday' and now even the CEO spends first Friday of the month on thinking and learning. Must learn about new technologies and how to use it in their business. Everyone including CEO must spend 40 hours on education and has to be clocked, this may include think Fridays or teaching or learning or anything like that.

Dr Kamel Mahadin: Social media: is decreasing productivity by 40%, youth is losing their passion and living off cellphones. Disagreement among panel as UK Panelist pointed out the value of social media in innovation and improved communication.

Agreement that we need to break the hierarchy so that managers must be hands on to work and learn continually.

Dr Meru, Tanzania: pointed out that exploitative relationships where companies bring own human resources and do not promote skills transfer. Africa has changed and is a place to do business, but also to add value and build local capacity.

Dr Valery Tsepkalov, capital comes from Latin word which means head. So capital is really about what's in your head. Silicon Valley has people from all over the world, so it's not about just what's there, need the right conditions - people came to Silicon Valley because it has the right resources to support creative and innovative ideas. You don't need to concentrate too much on really creative people, but you need

the environment and the creative people will emerge, you only needed 1 Bill Gates or Steve Jobs, but they were enough. If you not a big economy, you must concentrate in technology on something specific and focus on a cluster of technology cause you can't compete on everything. He started a technology software network in Bellerose, which now has grown into 140 companies. Identified gap in academia and in 5 years created 60 labs in the universities which were supported by companies and students could choose whether they would like to learn in these labs. However labs must also be integrated into education systems, and those that use it can become easily integrated into High Tech Park. Another perspective, need to promote and enhance creativity.

SOME KEY POINTS TO TAKE AWAY:

1. Use SEZs as a learning experience, a lab from which the country can develop concepts that get applied to the whole economy.
2. Ensure that the firms in the SEZ integrate with firms in the local economy.
3. Good Infrastructure and skills are essential to success.
4. Incentives as an added bonus, but there needs to be a good business case in the first place.
5. Economies evolve and in mature economies, SEZs are focusing on technology, Research and Development and the knowledge economy.
6. The area must have the right support environment to ensure that particular industry/industries flourish – the environment which fosters innovation and creativity is very important.
7. The trade environment is very important – RTAs and PTAs, etc. are all important for SEZs to work and the SEZ must be developed within the context of fostering international trade.
8. Trade finance and particularly trade finance for SMEs is an area that needs focus within the national policy context.
9. The streamlining of the trade environment, creating single windows, fostering ease of doing business are critical factors – if these things work well then trade is not restricted to the SEZ, but the whole area becomes 'special'.
10. Local authorities have an important role to play in fostering trade, by creating read-made industrial parks which make firm location very easy, minimizing time delays and lost production.