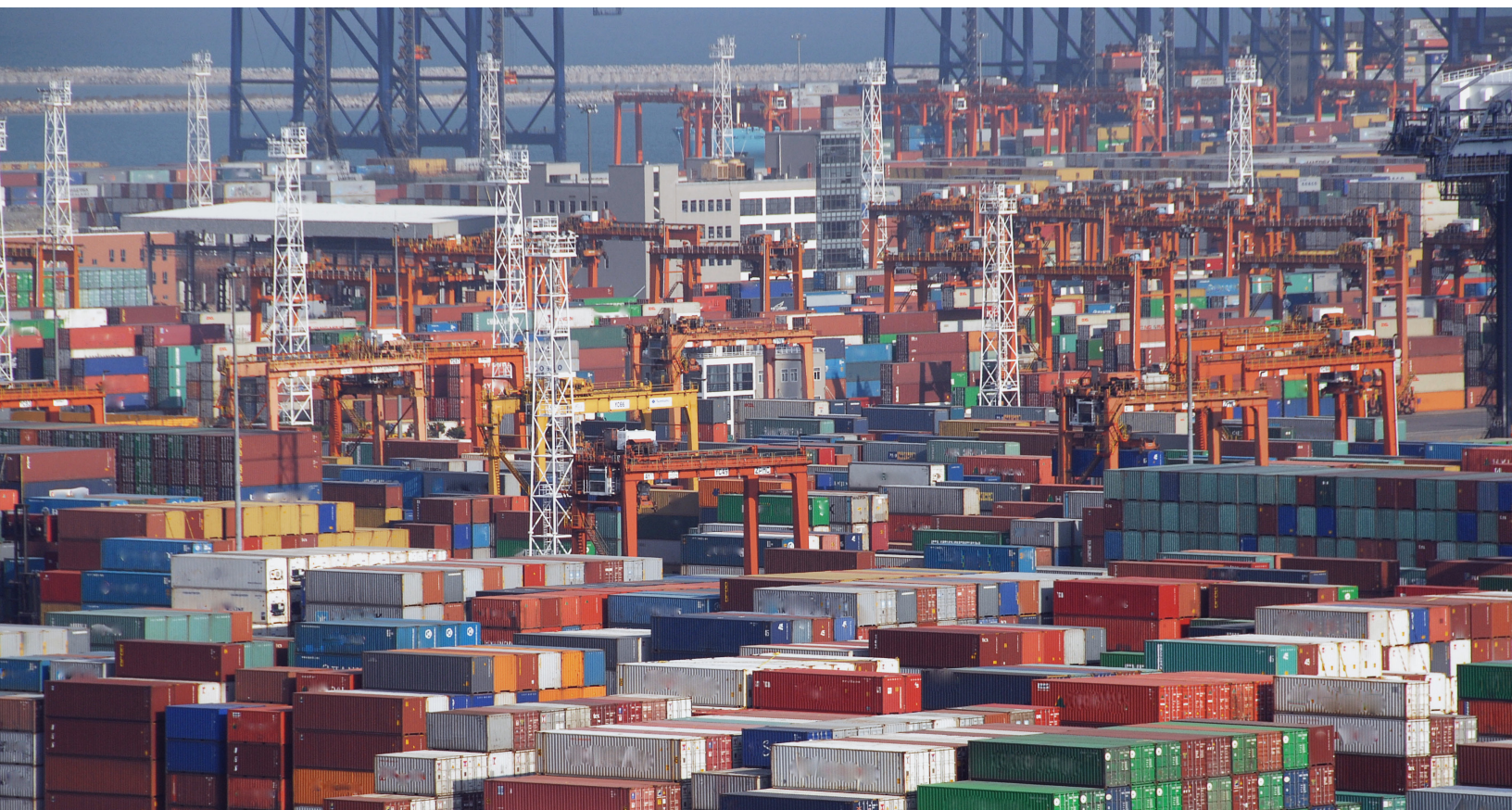


Public Sector Practice

How customs agencies can help special economic zones succeed

When agencies have a seat at the table and participate in areas such as governance and stakeholder relations, these zones have the best chance of promoting economic growth.

by Jonathan Davis, Tom Isherwood, Rachid Maalouli, Jon Spaner, and Reinier van der Lely



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Customs agencies play a key role in special economic zones (SEZs) by facilitating trade, safeguarding compliance, and (sometimes) collecting revenues. Yet they often struggle to make an impact, perhaps as a result of their relative lack of authority and of idiosyncratic local rules and regulations. A common result is that SEZs fail to reach their potential.

SEZs are complex. Many of them are exempt from taxation and have been set up to promote simpler trade, so customs agencies must tailor their approaches. What's more, their economic contribution is far from certain: while some generate wealth for the economy as a whole, others become hubs for smuggling, counterfeiting, and money laundering.

That doesn't have to happen. If customs agencies become more involved with SEZs, they are more likely to succeed. To help SEZs flourish, these

agencies must be more like enablers and facilitators than rule enforcers. When they have a seat at the table and participate in areas such as governance and stakeholder relations, SEZs have the best chance of promoting economic growth.

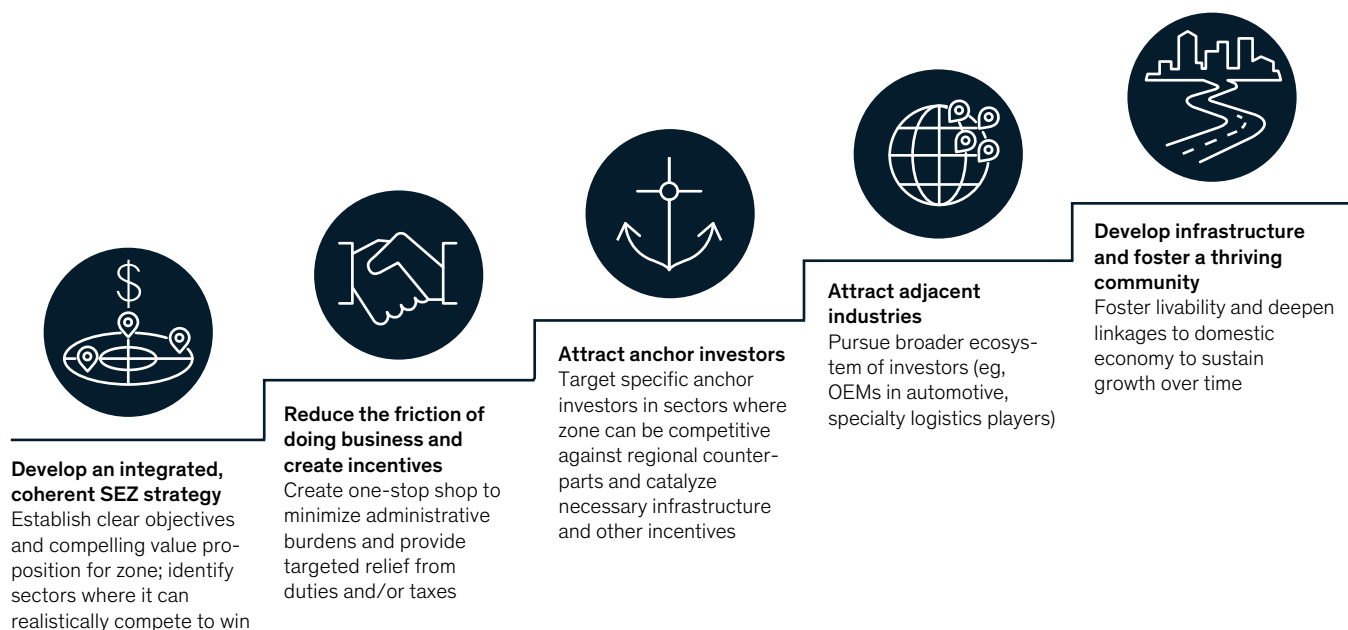
Five foundations for success

The number of SEZs around the world has increased from 800 in the mid-1990s to over 4,000 today. They have created around 70 million jobs.¹ Their expansion means that they have become central to the economic-development agendas of many countries. Governments that make them work tend to excel in five key areas (exhibit):

- **Develop an integrated, coherent strategy.**
Successful zones usually emerge from a detailed analysis of how they will create value for the broader economy. The analysis defines the value proposition of the zone to show how it

Exhibit

Five crucial steps can maximize the chances that special economic zones (SEZs) will succeed.



¹ "Special economic zones: Performance, lessons learned, and implications for zone development," World Bank Group, 2008.

can attract investment in a fiercely competitive global SEZ environment. Some zones are more productive by design. Those that serve as pure transshipment hubs create little value beyond jobs at the port itself, but if policy makers see transshipment as the foundation of a wider ecosystem, zones become a different proposition: they must highlight factors such as ease of access to the supply chain and the ability to attract and develop local talent.

- **Reduce friction and create incentives.** The scope and scale of incentives is in general directly tied to the value proposition's strength. Some zones have large natural advantages: maritime access, proximity to big regional economies, a pleasant living and working environment. They call for less investment than zones where investors need more convincing to make the leap.
- **Attract anchor investors.** Typical anchor investors are companies, relatively high in the supply chain, that pull in downstream suppliers and ancillary businesses. To win anchor investors, SEZs must make a convincing case about matters such as infrastructure, costs, and transport links.
- **Attract adjacent industries.** Successful zones identify adjacencies among suppliers, training providers, and related businesses. Once anchor investors are in place, these adjacent players create a powerful ecosystem of mutual interests.
- **Develop infrastructure and foster a thriving community.** Zones that successfully attract investors focus on creating an attractive place to live and work—everything from careful land planning through investment in schools and leisure opportunities.

Successful SEZs bring significant economic benefits. Shenzhen SEZ, for example, accounted

for \$338 billion of China's GDP in 2017, larger than that of Singapore and Hong Kong. That's impressive, since Shenzhen was a small county in the 1980s.² Shenzhen raised its GDP per capita by about 25 percent a year from 1978 to 2014 and doubled its nominal output between 2011 and 2018. In Dubai, total trade volumes in the economic free zones grew by 22 percent year on year in the first nine months of 2018 alone.³ In Bangladesh, the export-processing zones employed 481,000 direct workers in 2017 and contributed 19 percent of total exports.⁴

The flip side

Still, these success stories have a flip side: ill-conceived or badly implemented SEZs can have a significant negative effect. A relative lack of regulation and oversight, for example, creates opportunities for illicit activities, including trade in counterfeit goods, money laundering, and trafficking in human beings, drugs, and weapons. In a recent study, the Organisation for Economic Cooperation and Development found that the existence, number, and size of free trade zones (FTZ), a subset of SEZs, is correlated with the value of counterfeit and pirated products exported. The study found that, on average, each additional FTZ is associated with a 5.9 percent increase in the value of problematic exports.⁵

Despite the efforts of governments, a large number of SEZs fail to meet many of their objectives. In a McKinsey study of 30 such zones, half underperformed their national economies. Why do SEZs fail? Sometimes the value proposition isn't right or the zone isn't competitive against regional peers. In other cases, execution falters. In the mind-set of policy makers, if they provide tax and duty concessions, investors will come. But in reality, concessions are helpful though hardly adequate in themselves; SEZs must also have excellent infrastructure, streamlined port and customs operations, simplified clearance procedures, and a

² Frank Holmes, "China's new special economic zone evokes memories of Shenzhen," *Forbes*, April 21, 2017, forbes.com.

³ Sarah Townsend, "Dubai free zones saw 22% trade growth this year, government says," *The National*, December 22, 2018, thenational.ae.

⁴ *Bangladesh policy notes: The rise of special economic zones in Bangladesh*, World Bank Policy Note, January 2018, worldbank.org.

⁵ *Trade in counterfeit goods and free trade zones: Evidence from recent trends*, Organisation for Economic Cooperation and Development, March 2018, oecd-library.org.

host of soft advantages that combine to create an attractive package.

What can customs do?

When considering whether to invest in SEZs, companies require information about a range of factors, including governance and infrastructure, the availability of local talent, and access to schools and hospitals. These are the key questions companies will probably ask:

- Are we confident that the zone's governance is stable and that foundational policies won't change from administration to administration? Does the country in question have the right trade agreements? Will authorities comply with promises made about tax deductions and the facilitation of trade?
- Is the port's infrastructure, together with nearby roads and rail facilities, adequate to support operations? Will access into and out of the zone be fast enough? Can our suppliers establish themselves in the zone?
- Will we be able to attract and develop local talent? Can we bring in experienced managers to support operations for a number of years?
- If we can bring in such managers, will they find reasonably attractive places to live with their families? Are there schools for international children?

Customs agencies can play a key role in helping to achieve these objectives. They can make a difference in five key areas.⁶

Deliver on promises. Customs must deliver on the promises made to investors about trade facilitation. Investors both want and need to see that customs is part of the process of setting up the SEZ and will ensure that trade-promotion and -facilitation incentives are in place. It's important to move

beyond memoranda of understanding toward service-level agreements with port operators, facility managers, and (where SEZs are privately run) customs agencies, which can facilitate progress by locating local units close to SEZs.

Use information to inform strategy. Customs agencies are challenged by the limited insight from declarations of incoming and outgoing goods, especially in SEZs. In addition, other government agencies and the business community exert pressure to improve business facilitation by minimizing processing times. Meanwhile, the digitization of the logistics supply chain is accelerating, with innovations such as automated pallet-handling systems cutting shipment-processing times by as much as 50 percent.⁷ To be effective, customs agencies must maximize their information resources and keep up with these changes by building data sets and using cutting-edge analytics for activities such as facilitation, risk screening, and enforcement. These agencies can then focus their interventions on the minimum number of shipments while still achieving their revenue and security objectives.

Secure a seat at the table. Agencies need a seat at the table from the initial proposal to establish a SEZ through the daily operations management of an established SEZ, so they can engage regularly and effectively with the rest of the government and with industry. In our experience, when customs agencies embrace a problem-solving mind-set, their insights and expertise are usually welcomed.

Safeguard good governance. Customs must take the lead in designing and upholding proper governance frameworks to ensure that zones are managed according to local, regional, and global regulatory requirements.

Become global ambassadors. Leading customs agencies should reach out to peers around the world to discuss common challenges and develop best practices through bilateral discussions,

⁶ A version of this perspective was shared at a WCO technical-committee meeting in February 2019. Member states provided many valuable comments, and we are grateful for this input.

⁷ Ashutosh Dekhne, Greg Hastings, John Murnane, and Florian Neuhaus, "Automation in logistics, Big opportunity, bigger uncertainty," April 2019, McKinsey.com.

partnerships, and regional bodies like the World Customs Organization. The key is for customs agencies not only to focus on the challenges but also to share success stories.

Special economic zones can be powerful drivers of economic growth, but if they are badly planned or executed, they can promote illicit activity. As governments consider their options, customs agencies have an important role to play. The five key elements of successful SEZs—strategy,

incentives, anchor tenants, adjacent industries, and infrastructure—can all benefit from the close involvement of customs agencies, which can liaise between governments and investors, solve problems, and ensure adherence to essential rules and regulations.

Customs agencies must ensure that they can make a valuable contribution by securing a seat at the table and coming to it equipped with the knowledge and data that help streamline the process of establishing a successful SEZ. Agencies that can maximize their own potential will probably play a vital role in the success of SEZs that deliver long-term benefits.

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