The reinvention of the EPZs

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AFTER STANDING STILL for 24 years, in the second Lula administration and now under current President Rousseff Brazilian Export Processing Zones (EPZs)—areas that serve as a type of industrial park, tax-exempt areas mainly for facilities that export and import inputs and raw materials — have gained new momentum. Some are considered them as a mechanism for averting the recent crisis in the industrial sector, since they can give impetus to exports and boost local economies.

However, advocates warn that EPZs should be recognized as just one component of a broad industrial policy, not as the answer to all of industry’s problems. “We must think of the scheme as an alternative. I do not believe that it is a panacea,” says Gustavo Fontenele, executive secretary, National Council of Export Processing Zones (CZPE), which is an agency of the Ministry of Development, Industry and Foreign Trade. There are certainly questions, such as how this solution, which has been around for quite a long time, can in a scenario of international crisis support a model that is based on exports.

Changes coming?

Questions like these have led to a proposed revision of the legal framework for EPZs in order to bring new life to states,
Brazilian EPZs

**Incentives**

- Tax on Industrial Products (IPI),
- Contribution to finance the Social Security (Cofins),
- Contribution to Social Integration Program and Public Servant Fund (PIS and Pasep),
- Import Tax,
- Cofins on imports, and
- Freight Surcharge for Renovation of Merchant Shipping.

**EPZ’s objectives**

- Attract foreign investments directed to exports,
- Level the playing field for national companies and foreign competitors,
- Create jobs,
- Increase the value of exports and strengthen the external balance of payments,
- Disseminate new technologies and best management practices, and
- Correct regional imbalances.
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municipalities, parliamentarians, and businesses. “The EPZ is a kind of production paradise. It is the place where you can work and produce without the constraints the government otherwise imposes on businesses,” says Peter Pedrossian Neto, professor of economics, Catholic University of São Paulo and business director of the management company of the Export Processing Zone of Bataguassu (Egezpe) in Mato Grosso do Sul state. Encouraged by discussions about the bill in the Senate to amend a few points in the current legislation, Pedrossian highlights the advantages provided in the EPZ model as the main attraction for businesses, since the tax exemptions greatly reduce the Brazil cost.

“It costs about 40% less for a company to acquire or improve capital goods,” agrees Germano Augusto Pereira e Silva, AS Pontes Construtora, who is president of Egezpe. He says that current EPZ rules allow companies to buy industrial plants in other countries and reassemble them in Brazil without having to pay import duties. That is also true for acquiring software and parts: “This, coupled with the exemption for inputs purchased to make the final product for export and the benefits granted by states and municipalities, also reduces operating expenses.”

Even if markets are shrinking, the partners are optimistic: they see the crisis as a challenge that, if addressed, can drive development. “With the dollar reaching a reasonable level for the Brazilian exporter, it makes us more competitive,” says Pereira e Silva.

However, according to Helson Braga, president of the Brazilian Association of Export Processing Zones (Abrazpe) and a proponent of EPZs since the late 1980s, sluggish global demand makes it harder to fulfill the current rule requiring export of four-fifths of EPZ production (the remaining 20% can be sold in the domestic market but suspension of taxes and duties is revoked). “Today, it is very difficult for you to commit to export 80% [of production] when the global economy is stagnant and there is a violent struggle for market share,” Braga says. He also says that the high export requirement is not attractive to investors: “Few Brazilian companies are able to export so high a share of their production.”

Senator Lídice da Mata (PSB-BA), author of the bill to amend the current legislation (Senate Bill [PLS] 764/11), advocates reducing the export requirement from 80% to 60%, and even to 50% in some cases. “Many countries have eliminated this requirement, provided all taxes due on domestic sales are paid in full, which already happens here,” she says.
Some segments of industry criticize reducing the EPZ export requirement and expanding domestic sales as unfair competition. Proponents of EPZs feel strongly, however, that this is not a danger. “When the company sells in the domestic market, it pays all taxes that have been suspended. Sale from an EPZ to the domestic market has exactly the same treatment as a normal import from China, Korea, or Germany. The notable difference is that when you buy from those countries, you create jobs there, when you buy here, you are creating jobs here,” Braga emphasizes.

Another change under discussion in Congress is to allow service providers to set up operations in EPZs, which now may only support manufacturing companies. “The EPZ model of the 1970s, exclusively dedicated to manufacturing, has evolved. Today, it covers services, hospitals, even universities. Brazil needs to adjust to these new times. In the case of IT services, several studies have shown that Brazil has the potential to gain a significant share of the market, which is currently dominated by China and India,” says Senator da Mata.

Cost avoidance?
While EPZs are just now taking off in Brazil, the initiative is not new in the rest of the world. The earliest EPZs date from the 1960s in Ireland, India, and Taiwan. In the 1970s, South Korea and China adopted the model to expand markets and further increase their savings. Currently, according to a World Bank 2009 survey, there are about 3,500 EPZs in 135 countries; they account for 68 million jobs and turn over about US$500 billion annually.

Here, EPZs have been seen as a way of avoid the Brazil cost, much of it attributable to the bureaucracy, and to circumvent the difficulty of accessing funding and logistical problems. “The EPZs have a special tax regime where the suffocating tax burden does not exist,” Pedrossian says.

Another difference has to do with the foreign exchange freedom afforded to EPZ producers, which have the right to retain abroad all the revenues from exports. Pedrossian explains, “There is no commitment to bring in foreign currency and the paperwork is less. Producers are exempted from licenses to import and export.”

“All these advantages are valid for 20 years, and renewable for the same period,” says Braga, which he believes is reassuring.
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boosting local economies is very attractive. Braga noted that in some countries formation of EPZs has in turn triggered formation of new industries in regions around the EPZs, which were established to supply raw materials and supplies to companies in the EPZs.

“Small and medium businesses can benefit in several ways,” Senator da Mata says. “They may use incentives and conditions to grow by selling to foreign markets, or they can exploit opportunities to become suppliers to companies located in EPZs. Furthermore, EPZs stimulate the development of urban centers.”

Egezpe president Pereira e Silva agrees: “It’s a program that can make Brazil stronger by encouraging the export features that we do not have today. . . . With exports, the country becomes more competitive, it can compete in the global market. We interact with the world, and we are not left behind just buying imported manufactures.”

Attractive to governments
For state and local governments, which must apply to set up EPZs, the possibility of reducing regional imbalances and