

**Special Economic Zones for the Digital Economy**

**Abdurakhmanov Abdulaziz**

*Tashkent State University of Economics*

*Student of the Faculty of Economics*

[abduraxmonovabdulaziz7679@gmail.com](mailto:abduraxmonovabdulaziz7679@gmail.com)

***Abstract: Many countries have also created specialized enclaves (physical and virtual) to boost digital commerce and innovation. In many ways, these parallel the role played by Special Economic Zones (SEZs) in manufacturing. By providing SEZ firms with superior infrastructure – and exempting them from many levies and procedures – such zones helped many countries boost manufacturing FDI, exports and innovation.***

***Keywords: business process, digitalization, competitiveness, digital system, business model, cloud technologies, management solutions, corporate information system.***

The oldest form of specialized digital economy enclave is the digital technology park. This is a direct progression from the research & science parks/technology parks first set up over fifty years ago. Firms locating in such parks are provided with specialized and superior equipment, infrastructure, and laboratory facilities, at a subsidized cost, to better enable them to undertake high-end research and innovation of national and commercial use. Asia already has several such parks, producing and exporting electronics hardware (e.g., China, Indonesia, Malaysia, Republic of Korea, Taiwan Province of China, Thailand, and Viet Nam).

Some countries have set up software parks – that is, SEZ dedicated to exporting software and professional service. Founded in 1991, India's parks are possibly amongst the world's most successful. Many foreign and domestic firms participate but are carefully selected based on their export proposals – and must export 100% of the software/professional services they generate under the auspices of this scheme. In return, they are exempt from income tax for 5-10 years, can import the necessary hardware and software for their products duty free, and even re-export some of it under certain conditions. Firms exporting more than a certain amount can even sell up to 50 per cent of exports in the domestic tariff area. While initially firms were required to locate in specified physical zones to avail of superior electricity and global connectivity, this requirement has gradually been relaxed and qualifying firms can locate anywhere in India. In 2020, the Indian Government even permitted workers in qualifying firms to work from home.

Many of today's digital technology parks aim to become world leaders in specific digital technologies. Malaysia's Multimedia Super Corridor is a specialized hub for both producers and consumers of multimedia media technology and content. Its drone and robotics park at Johor – Southeast Asia's first – speeds local development and commercialization of these technologies to national advantage. Cyberjaya, just outside Kuala Lumpur – already home to over 2,300 start-ups, SMEs and large tech businesses – is working to become a major hub for ICT and multimedia research and industry. Target investors include multinational enterprises wishing to harness multimedia technology to guide their global manufacturing and trading operations.

Today's most advanced digital technology parks typically spread across a wider area, containing residential, commercial, leisure and outdoors facilities, so that they might attract and retain the world's best talent. They are thus referred to as 'innovation districts.' In Asia, Cyberjaya and Singapore's Jurong Innovation District (JID) are pioneering examples. JID is "designed to be Singapore's largest living lab" for the development and prototyping of 4IR technologies. Its facilities

include (1) research and prototyping labs for advanced manufacturing and digital technologies, including 5G and autonomous vehicles, (2) specialized office buildings for established firms and startups focusing on 4IR and ‘smart city’ technologies, (3) advanced manufacturing factories, and (4) logistics facilities for the transportation of supplies and the export of manufactured goods.<sup>18</sup> Resulting innovations and prototypes – including enhanced 5G, autonomous vehicle and smart city technologies – can also be live-tested in the district. Many global companies have already located major 4IR R&D operations in JID, including Hyundai, Siemens, Bosch, Flowserve, and Shimano.

Digital technology parks, software parks and innovation districts generally seek out both foreign and domestic investors. Popular incentives include corporate tax exemptions of ten years or more, duty free import of equipment and other inputs, allowances on core business capital expenditures, tax breaks for R&D expenditures and locally generated patents. Some of China’s software and technology parks offer income tax breaks to employees of participating firms, while reducing the pension payments employers are compelled to make. Investors also receive a variety of nonfinancial incentives, including preferential access to talent and/or markets, permission to own land, policy advocacy and enhanced approval processes for licenses and visas.

Technology and innovation sandboxes Closely related to digital economy parks are digital ‘technology and innovation sandboxes,’ government-sponsored innovation programmes designed to speed up the development and commercialization of strategic digital technologies by local entrepreneurs. By underwriting such ‘sandboxes,’ host governments seek to competitively select the best local technologies and become global hubs for these digital technologies.

Malaysia’s National Technology and Innovation Sandbox (NTIS), for example, enables local digital economy researchers, innovators, start-ups and high-tech entrepreneurs to test their products, services, business models and delivery mechanisms in a live environment, and relaxes selected processes and/or regulatory requirements to speed up commercialization. Current priority areas are healthcare, manufacturing, agriculture, education, travel and tourism. NTIS is thus currently supporting the development of robots to help front line hospital workers treat Covid-19 patients and the recovery of those affected by stroke and other illnesses; semi-ventilators to assist patients with breathing difficulties; agricultural robots to enhance agricultural worker efficiency; automated drone that spray pesticide precisely; and manufacturing robots for pick-and-place functions.

Other examples are Hong Kong, China; and India, which have established digital innovation ‘sandboxes’ for the development and piloting of digital finance and insurance solutions. (Finextra, 2020; disruptive.asia, 2020).

Currently, some sandboxes only permit the participation of local innovators, while other enable foreign firms to take part.

#### Cross-border e-commerce Zones/ Digital Free Trade Zones

A completely novel type of enclave is the ‘Cross-Border E-Commerce (CBEC) zone,’ first piloted by China in 2015 at Hangzhou. The express purpose of such zones is to boost cross-border e-commerce, by facilitating international e-commerce shipments to individual consumers. Local firms locating in such zones can directly ship online orders to individual customers overseas. In parallel, overseas e-commerce platforms fulfilling orders from overseas retail customers can ship products to CBEC zones in their country for onward delivery. In China, consumers currently place international orders through the relevant CBEC zone website, and the foreign e-commerce supplier immediately ships the product to this zone, generally by airplane (Dezan Shira and Associates, 2020). Once cleared by the zone’s customs office, the product is delivered to the consumer.

Since, in both cases, e-commerce orders are imported or exported for personal use and cannot be resold, CBEC firms are exempt from licensing approvals, value-added tax and pay reduced

corporate income tax. CBEC exports are also exempt from retail consumption tax. However, retail importation is only permitted for products appearing on the Government’s “List of Goods under Cross-border E-commerce Retail Importation” , which range from infant formula, health food and medical devices, to frozen aquatic products, alcohol, and consumer goods. Consumers do not pay duties for single transactions worth up to RMB 5,000 (US\$729). The maximum individual quota for annual importation is RMB 26,000 (US\$3,791) (Dezan Shira and Associates, 2020).

China now has 105 pilot CBEC zones spread across the country, including more remote, internal areas (Dezan Shira and Associates, 2020a). Participating firms can now fulfil all customs procedures within their respective zone, greatly speeding shipments to foreign and Chinese customers, and facilitating returns. This also makes it significantly easier for SMEs, listed on e-commerce websites, to service individual customers overseas. In 2019 alone, China’s CBECs dispatched more than 300 million parcels globally, of which 29.29 per cent went to the United States, followed by France (6.42 percent), Russian Federation (6.10 percent), the United Kingdom (5.55 percent), and Germany (4.59 percent) (Dezan Shira and Associates, 2020a). CBEC exports now account for over 11.25 percent of total Chinese exports – up from 2.2 percent in 2015 – and are likely to further increase rapidly this coming decade (Dezan Shira and Associates, 2020a).

An added benefit has been the mushrooming of new value chains, locally and internationally, since each zone contains a mix of e-commerce platforms and supply partners, manufacturing firms, transportation firms and financial services firms. China’s CBEC firms have also jointly invested in 1,200 warehouses internationally, in/from which they agglomerate and dispatch orders (Dezan Shira and Associates, 2020a).

Malaysia has been the first and only country so far to replicate and adapt this model, setting up a Digital Free Trade Zone (DFTZ) on the outskirts of Kuala Lumpur in early 2017. Its DFTZ’s key objectives are to (1) facilitate international purchases of Malaysian goods through international e-commerce platforms, (2) boost SME exports, and (3) grow Malaysia into an ASEAN fulfilment hub from which global e-commerce firms can service regional consumers. Firms locating in – or virtually affiliating with – the zone avail exemptions like that offered by China’s CBECs and practical support in e-fulfilment, finance, insurance, logistics, and customs and other clearances. The zone has also drawn investments from foreign e-commerce, real estate development, finance, and logistics firms, among others.

Virtual SEZs – A fourth – still emerging – model is what, for the purposes of this paper, could be named the ‘virtual SEZs’, in which host governments create digital platforms and skills that enable local workers to sell digital services globally. They could do this in partnership with – or with investments from – foreign firms.

Malaysia’s GLOW (Global Online Workforce) Penjana21 programme offers a pioneering example of this idea. This programme helps qualified Malaysians become “competitive digital freelancers, winning international jobs and project contracts on freelance platforms and earning sustainable income.” Launched in mid-2020, its digital platform and intensive training programme connects local workers with global assignments in the areas of website design, IT and software; writing and content; design, media, architecture; sales, marketing and social media; and data entry, administration and social assistantship. In tandem, the Malaysian Government’s Digital Talent Development Strategy continues to build the digital skillsets of local citizens, since workforce quality is the principal attraction for FDI in this sector.

Since ‘virtual SEZ’ workers deliver services digitally, they need not work from specified geographic locations, as in physical SEZs, but even from the comfort of their homes.

However, their participation in a government-intermediated and government-supported programme is the digital equivalent of physically locating them in the geographically delimited area of an SEZ. More importantly, as in physical SEZ, their ‘export’ of digital services creates foreign exchange earnings.

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