The Good in Services – Digital Free Zones in Nigeria as an economic tool

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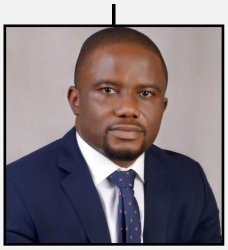

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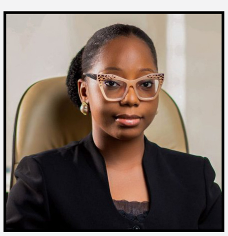

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Introduction

The idea of reduced barriers to international trade is growing, with national and regional governments increasingly inclining towards policies that promote free trade. The benefits of cross border exchange of goods and services to a domestic economy are proven by foreign exchange earnings, local job creation and skills development. Special economic zones ("SEZs") or free trade zones were created to attract businesses and foreign direct investment through fiscal incentives and compliance-friendly and less cumbersome regulations. Within these free zones, businesses could produce goods (usually for export) in a designated area set up to achieve more operational and cost efficiency relative to the customs territory (the rest of Nigeria). Research has shown that China's growth and a large factor that contributed to China becoming the strong economic power it is today was largely spurred by SEZs established in strategic Chinese cities.[1] Upon establishment of these SEZs, China's gross domestic product ("GDP") was recorded to have doubled seven times between 1978 and 2011, at an average rate of 103.01% each time and at four and a half year intervals.[2]

1 "Investigating the Key Strategic Factors Responsible for the Economic Landmarks of China: A Lesson for Nigeria" a conference paper published by the British Academy of Management in 2014.

2 Ibid

With this evidence, there are 3(three) key justifications for tweaking the concept of free zones in Nigeria to enhance the economic benefits.

First, the growing use of digital technology shows that the 3-dimensional concept of free zones is no longer the only option as a tool for economic reform. Practically all economic activities now have digital options across the entire value chain – from the upstream of input and production to the downstream activities of market access.

Second, services are gaining an increased share of the GDP of many national economies. While the production of goods may have driven economic growth in the industrial revolution, technology is now boosting the service sector to become a key driver of advanced economies; and this provides a useful template for developing economies – a category to which Nigeria belongs.[3]

Third, and closely related to the above, services are more immune to protectionist tools such as duties and other trade barriers placed on goods. This is even more the case where such services are tech-enabled.

This article explains how the concept of digital free zones designed for the services and knowledge-based economy can enable Nigeria to ride the wave of digitalisation to attain economic growth and become a hub for regional and international trade.

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3 Indermit Gill "At your service? Developing economies bet on service industries for growth" (World Bank Blog, published on 27 September 2021) [At your service? Developing economies bet on service industries for growth (worldbank.org)] accessed 14 August 2024.

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The concept of digital free trade zones

The concept of digital free zones was introduced amidst the demand for a more digitized world and economy. In this article, a Digital Free Zone ("DFZ") will be defined as a *designated area created to facilitate digital trade and e-commerce activities through the integrated use of modern technologies with traditional trade practices.* DFZs incorporate the use of advanced data centers, e-commerce platforms, high speed internet connectivity and other infrastructure to enable approved entities to operate within the zone. Like traditional free zones, they are not bound by the policies in the customs territory and have a customised set of rules to regulate their operations. DFZs appeal to businesses that offer digital-based services by allowing them to operate remotely without a physical presence while enjoying the same incentives as the traditional free zones.

Establishment of digital free zones in other jurisdictions

There have been precedents of the concept of DFZs in other jurisdictions; countries such as *Malaysia* and *Dubai* are currently pushing the boundaries of trade with this concept.

Malaysia has been credited as the first country to establish a digital free zone in 2017[4]. Through a partnership with Alibaba, Malaysia established an electronic world trade platform aimed at facilitating SME export activities by providing an infrastructure that will enable SMEs function in international markets. Malaysia's Digital Free Trade Zone consists of an e-service platform, a satellite services hub, and an e-fulfilment hub that is located near the Kuala Lumpur Inter-

4 "Malaysia's Digital Economy: A New Driver of Development", Report by the World Bank Group, published September 2018 https://documents1.worldbank.org/curated/en/099340511022235507/pdf/P1699760ce117e0f00b2c402a8e3f1f683c.pdf?_gl=1*18ce0n4*_gcl_au*NDI4MjMyODE3LjE3MjAwMjExMjU. accessed 2 August 2024

national Airport[5] . These structures seek to expedite e-commerce delivery and logistics, improve communication between Malaysian businesses and Chinese manufacturers, and incubate startups to foster digital economic growth. The Malaysian Digital Economy Corporation reported in 2020 that since its inception, the Digital Free Trade zone had helped 13,000 SMEs gain access to global markets when compared to the growing number of 2,000 in 2017 resulting in an overall improvement in its economy. [6]

Dubai has greatly benefited from the activities of the DFZs and SEZs established within the country, and this is evident in its economic upswing. Some of these zones include – the RAK Digital Assets Oasis dedicated to digital and virtual assets service providers; the Dubai Silicon Oasis designed for startups that specialize in e-commerce and online trading, the Dubai Virtual Commercial City Program which offers entrepreneurs a virtual company license for the incorporation and operation of businesses that render technology-related services within the United Arab Emirates.[7] As of 2021, Dubai's digital economy was reported to be valued at $62 billion, which equates to a 9.7% contribution to the national GDP.[8]

Estonia has also built a digital society known as e-Estonia where citizens can interact by electronic means. In 2014, Estonia became the first country to offer e-residency to non-resident citizens where such e-residents can create, manage and operate businesses from any part of the world. E-Estonia boasts of technology solutions such as e-banking where residents can easily conduct transactions digitally, e-ID - a digital identification system that allows residents to use

5 Hugh Harsono " The China-Malaysia Digital Free Trade Zone: National Security Considerations" published on the Diplomat < https://thediplomat.com/2020/07/the-china-malaysia-digital-free-trade-zone-national-security-considerations/ >accessed 2 August 2024.
6 Mui Yin Chin & Lee Peng Foo & Mohammad Falahat, 2023. "Digital Free Trade Zone in Facilitating Small Medium Enterprises for Globalisation: A Perspective from Malaysia Small and Medium Enterprises "Business and Economic Research, Macrothink Institute, vol. 13(2), pages 40-52
7 "Dubai Free Zones Guide" published by the International Free Zone Authority https://ifza.com/en/industry-analysis/dubai-free-zones/ accessed on 1 August 2024
8 "Dubai's Roadmap to becoming the Digital Economy Capital of the World" A special report published by the Dubai Chamber of Digital Economy, 2022. https://www.dubaichamberdigital.com/wp-content/uploads/2023/04/Dubai-Digitized-Economy-Entrepreneur.pdf accessed 15 August 2024.

their IDs to sign contracts, access healthcare services and even vote. Report shows that Estonia's GDP experienced a significant increase from \$5.7 billion in 2000 to \$36.3 billion in 2021. In January 2022, over €820 million was invested in Estonian startups due to the tech-enabling environment created in Estonia.[9]

The above is evidence that SEZs and more specifically, DFZs will present new opportunities for developing countries like Nigeria to grow their digital market and strengthen their economies.

Nigeria's current regulatory framework for Digital Free Zones

The Nigeria Export Processing Zones Act (the "**Act**") is the primary law that regulates free zones in Nigeria. Currently, the Act does not expressly provide for the establishment of DFZs, and this comes as no surprise considering that the Act was passed in 1992 to align with the concept of a traditional free zone.

However, in 2021, the third schedule to the Act was amended by NEPZA[10] through the Third Schedule Amendment Order (the "Order"). The Order introduced new approved activities in a zone such as *E-commerce and Virtual City, Entertainment Park and City, Medical Park and City, and Technology Park and City.* NEPZA, through the Order, seemed to recognise the emerging importance of tech-based entrepreneurship, innovation and services that are not limited by physical boundaries.

While the introduction of the Order is laudable, the current legal framework poses some chal-

9 Gerard O'Dwyer "Estonia: Digital Economy Drives Growth" (Global Finance, July 2022) https://gfmag.com/emerging-frontier-markets/estonia-digital-economy-drives-growth/ accessed 15 August 2024.
10 Nigeria Export Processing Zones Authority was established under Section 2 of the Act for the management of export processing zones in Nigeria amongst other functions and responsibilities.

lenges in the operation of DFZs in Nigeria. To remedy this, further amendments need to be made to the Act to address the following ambiguities:

- Free zone designation criteria: **Section 1 of the Act** stipulates that the President of the Federal Republic of Nigeria may by an order and upon the recommendation of NEPZA, designate an area to be an export processing zone. The term "area" as used in this section is not defined by the Act and can be construed to mean a physical location. Considering that a digital free zone (which asides from a physical location, can also be a web-based platform) does not fall under the ambit of an "area", a more inclusive definition of the term should be provided. This will ensure that the designation of DFZs is easier and less cumbersome.

- Approved activities: **Section 6 of the Act** provides that the activities specified in the Third Schedule of the Act shall be the approved activities which can be undertaken in the zones. By the Order, "e-commerce and virtual city" was introduced as an activity to be conducted by approved entities. However, the Order does not define what a virtual city means and how an approved entity may undertake such activity. Activities that consider the evolving nature of technology and innovation should be incorporated into the Act to address this challenge.

- Incentives: The Act also outlines the various incentives that approved enterprises within free zones are entitled to[11]. However, these incentives, originally designed for the tradition-al free zones, needs a recalibration to better suit digital services. For instance, incentives targeted at intellectual property or such other output of a knowledge-based economy and which will foster innovation and improve the ease of doing business will be effective.

11 By Section 18 of the Act. Incentives include rent-free land at construction stage, sale of 25% of production in customs territory, repatriation of foreign investment, no requirement of import and export licenses, amongst others

- <u>Tariffs:</u> The Free Zones (Tariffs and Other Charges) Order, 2002 (the "Order") also provides for applicable tariffs for approved entities with the free zones. Section 1 of this Order provides that *"all products manufactured, assembled, pre-packaged and sold in the free zones shall be sold in the customs territory subject to tariffs and other charges"*. The legal and operational implementation of this provision for DFZs will be difficult, as digital services do not fall under products that can be "manufactured, assembled or pre-packaged". Therefore, other tariffs (if any) that will be applicable to a DFZ should be introduced to prevent any ambiguities in the implementation of the Act.

Lastly, **Section 42 of the Startup Act 2022** provides that the National Information Technology Development Agency ("NITDA") shall collaborate with NEPZA for the establishment of a Technology Development Zone which shall grant licence to any startup, accelerator, or incubator prior to the commencement of any approved activity. One cannot ascertain that the intention of this "Technology Development Zone", was to accommodate the concept of a DFZ. However, a potential collaboration between NEPZA and NITDA when leveraged can encourage the trade of digital products and services by tech-based startups within the Technology Development Zone.

The future of Digital Free Zones in Nigeria

The idea of digital free zones is a welcome innovation in Nigeria, given its massive potential to boost the country's economy. Research shows that the projected growth rate of Africa's financial services market is about 10% per annum, amounting to about $230 billion in revenues by 2025. Nigeria's fintech sector alone is said to be responsible for 33.3% of Africa's fintech market.[12] While these projections are encouraging, the potential of the average fintech, or service-based startup incubated within a digital free zone is limitless.

Through the introduction of DFZs like Itana into its international trade ecosystem, Nigeria like its counterparts - China, Dubai and Malaysia will successfully shift from focusing solely on physical goods and services, to digital-based services. However, there remains a need for an efficient regulatory and operational framework to serve as an enabler for tech-based investments though regulated within Nigeria's digital landscape, but capable of operating across the African continent and globally.

12 Dahlia Khalifa "How Nigeria can leverage the rise of fintech for economic progress" (World Bank Blogs, 4 April 2024) , <https://blogs.worldbank.org/en/psd/how-nigeria-can-leverage-the-rise-of-fintech-for-economic-progre#:~:text=There%20is%20much%20growth%20potential,third%20of%20Africa's%20fintech%20market.. Accessed 15 August 2024.