

Introduction to International Free Zones



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Free Zones

Introduction

The purpose of this document is to provide a brief introduction to the establishment and operation of an international Free Zone. For developing countries and other economies in transition, the development of some form of "Free Zone" can be an excellent step towards stimulating economic activity while introducing natural market reforms. Properly planned, Free Zones generate beneficial investments and jobs.

This overview discusses the following issues:

- √ What is a Free Zone? This section discusses the free zone concept.
- √ Why Create a Free Zone? This section discusses the reasons countries develop Free Zones.
- √ What Makes a Good Free Zone? This section describes the results of case studies comparing and contrasting over three hundred Free Zones and discusses a set of characteristics that lead to successful Free Zones.
- √ Case Study: Mauritius. This section is a brief case study of a successful Free Zone.
- √ How to Create a Free Zone. This section discusses the steps necessary to create a Free Zone.

This overview was prepared by The Meneren Corporation (TMC), a U.S. based company specializing in the planning and development of international Free Zones, and the development and management of major transportation infrastructure programs.

Other Free Zone Names

- **Customs Zone**
- **Duty Free Export-Processing Zone**
- **Export Free Zone**
- **Export Processing Zone**
- **Foreign Trade Zone**
- **Free Export Processing Zone**
- **Free Production Zone**
- **Free Trade Zone Free Port**
- **Industrial Free Zone**
- **Investment Promotion Zone**
- **Joint Enterprise Zone**
- **Privileged Export Zone**
- **Special Economic Zone**
- **Tax Free Trade Zone**

Free Zones

What is a Free Zone?

A Free Zone is generally defined as:

A designated geographical area where unrestricted activities of industry, commerce, trade, and construction take place, and where the unrestricted flow of goods and services is permitted to the rest of the world.

Usually, Free Zones are territorial enclaves which are outside a country's customs zone. In the past 30 years the terminology used to describe what has traditionally been called a "Free Zone" has evolved significantly. Some of the more important types of Free Zones include the Free Trade Zone, the Free Port, and the Export Processing Zone.

A **Free Trade Zone (FTZ)** is a defined geographic area where the unrestricted flow of trade is permitted. The area can be anywhere within a country. Items that are imported and then exported within the Free Trade Zone are free from customs duties. Typical activities in this zone include transshipment of goods, storage of goods in warehouses, packaging of bulk items into smaller or individual packages, inspection of components, and regional cargo distribution centers.

A **Free Port** is a Free Zone specifically linked to a seaport or airport. Free Ports were created to ease governmental restrictions so that goods can flow freely. Free Ports allow import and export of goods



free of duty and sometimes taxes, and provide enterprises with financial, tax, investment and regulatory incentives. Banking, trade barriers, and employment rules are relaxed within the boundaries of a Free Port. Some Free Ports have recently added multimodal cargo transfer to land transportation systems as a new service option.

An **Export Processing Zone (EPZ)** is defined as an area in which foreign firms, benefiting from special incentives and privileges, produce goods for export. They are often industrial estates offering customs privileges and financial incentives to attract foreign investment in export-oriented manufacturing enterprises.

Typical Free Zone incentives are:

- √ **Foreign ownership of firms operating within the zone**
- √ **Duty free or reduced duty import of capital equipment**
- √ **Duty free or reduced duty import of raw material**
- √ **Duty free or reduced duty export of goods processed within the free zone to areas outside the customs zone**
- √ **Free flow of currency**
- √ **Full repatriation of profits**
- √ **Fixed term income tax holiday of company profits within free zone**

In 1989, there were over 200 Export Processing Zones in operation worldwide, 100 more were under construction, and 50 were in the planning stage. Although there are successful examples of Export Processing Zones on most continents, EPZs have proved to be most successful in the newly industrialized countries of Asia.

Free Zones

Why Create a Free Zone?

There are two goals behind the development of most free zones. The first goal is the desire to generate economic growth. The second goal is to integrate the regional economy with the global economy.

A Free Zone acts to stimulate growth because the capital, technology and resources introduced into the zone create new job opportunities for local workers and business opportunities for local companies to sell goods to enterprises within the zone. Most often, the activity is driven by Foreign Direct Investment (FDI).

The Free Zone integrates the region with the global economy by creating goods for export, attracting foreign currency, and providing opportunities for companies outside the free zone to trade with international firms.

Free Zones are developed to take advantage of a country's comparative advantage in natural resources, existing infrastructure, or labor. Most Free Zones are developed around existing infrastructure to reduce the amount of investment required, to support the facilities already in place, and to promote continuing infrastructure development.

Free Zones of all types are tools used by governments to create areas of concentrated commercial, trade, or industrial activity.



Free Zones rely on access to transportation to make them viable. Indeed, it was an airport that caused the development of the first EPZ. For most Free Zones, access to one or more modes of transport is critically necessary for the successful development of the Free Zone.

Finally, a Free Zone can serve as a region where a country with an economy in transition can liberalize the economy without having to make dramatic changes in laws and tradition throughout the rest of the country.

A Free Zone

- Creates an investment environment
- Achieves sustainable development
- Promotes indigenous innovations
- Secures self-reliance
- Protects the natural, built and human environment

Free Zones

What Makes a Good Free Zone?

Most Free Zones are unique because their geographic areas are unique. Therefore what works in one location may not work in another. However, there are Free Zone characteristics that stand out above all the rest in determining the success of a Free Zone.

Key characteristics of a successful Free Zone are:

- Government Support
- Adequate Infrastructure
- Streamlined Procedures
- Maximized Use of Natural Resources
- Plan for the Future

Government Support

The entire country must support the development and operation of the Free Zone. This support is usually in the form of a strong legal framework for the Free Zone. Government agencies such as customs, immigration and finance must also be supportive. Early integration of the Free Zone into the government's programs, will prevent problems in all stages of development.

Adequate Infrastructure

Every successful Free Zone has emphasized the importance of providing adequate infrastructure as a key in attracting investment. Transportation, power, water, sewer and telecommunications are all important infrastructure requirements.



Streamlined Procedures

The most successful Free Zones have streamlined customs procedures for handling goods entering the Free Zone. When procedures are streamlined, investors are attracted to the area more readily because they are confident their goods will be handled without unnecessary delay. In the logistics business, time is money.

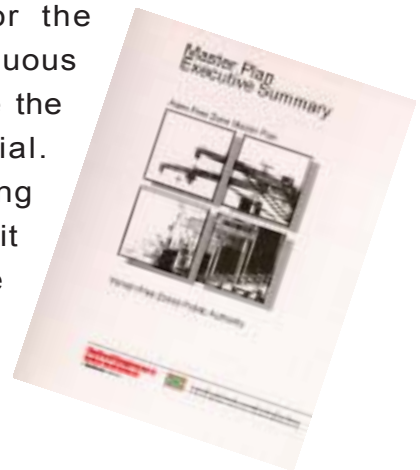


Maximized Use of Natural Resources

Each Free Zone analyzed was located in an area with vastly different natural resources. In this context, natural resources can include labor, land, location, minerals or hydrocarbons. Utilizing the resources of a given area to the fullest extent possible is key to success of a Free Zone.

Plan for the Future

Planning for the future is necessary for the successful growth of a Free Zone. Continuous updating of the Free Zone plan to anticipate the needs of long term development is crucial. While detailed and comprehensive planning on this scale takes time and investment, it ensures that the overall impact of the extensive infrastructure improvements will be positive and have long lasting value to both the local population (work force) and investors.



Free Zones

Case Study: Mauritius

Mauritius is a small, densely populated Indian Ocean island located 1000 miles off the eastern coast of the African continent. Mauritius gained its independence from Great Britain in 1968. Since 1970, the Mauritian government has sought to promote export processing zone industries in order to diversify its economy away from dependence on French established sugar plantations. As a result, the EPZ industries now contribute substantially to the Gross Domestic Product (GDP) of Mauritius. More importantly, the EPZs have provided significant employment opportunities to Mauritians, to the extent that there is now a limited labor shortage in Mauritius. The factors that have contributed to Mauritius' success are:

Government Institutional and Country support

The success of Mauritian EPZs demonstrates the importance of having the support of the relevant regulatory bodies. The parliament of Mauritius has passed far-sighted laws taking advantage of Mauritian strengths and have put it on the path of sustainable development. This includes developing and maintaining good relations with markets, and understanding the implication of tariff regulations in these markets.

Suitable Infrastructure

Domestic Mauritian capital investment in EPZ industries is sometimes as high as 50%. Spending has centered on transport equipment, construction of nonresidential buildings, machinery for the export zones, hotels and industrial estates and major public works in transportation infrastructure and the airport.

Streamlined Procedures

Early on, Mauritius adopted the "One Stop Shop" approach to

permitting and adopted simple and efficient customs procedures. They continue to further refine this system with modern Electronic Data Interchange (EDI) technology which they are extending to other government functions.

Maximized Use of Resources

Mauritius took advantage of a comparative advantage and maximized a resource - a literate and highly trainable but underemployed population. When the processing zones began operations, labor was inexpensive and abundant. When the zones began, this quality was an influential factor in the quick expansion of the EPZs. Unemployment, as high as 25% prior to the government's industrialization EPZ commitment, is now as low as 2%.

Plan for the Future

Mauritius' EPZs have concentrated primarily in textiles and apparel manufacture. Diversification of the manufacturing sector has encouraged the development of electronics and component manufacture and has decreased the labor shortage by moving away from labor intensive products. Formally adopted "Development Schemes" have included agriculture, film industry, industrial parks, hotel management, offshore companies and offshore banking.

In 1968, Faced with a government in transition and an economy dependent on a single crop, the Mauritian government focused on the creation of EPZs to increase exports, create jobs, and diversify the economy.

Mauritius' economic success has won recognition at the international level. Both the International Monetary Fund and the World Bank cite Mauritius as an example of remarkable progress in implementing a program combining adjustment, growth, and modernization.

Free Zones

How to Create a Free Zone

To be successful, a Free Zone project requires the development of a legal, financial, and business framework and the application of solid planning and engineering expertise. The key is to create an environment where firms wish to invest.

Successful Free Zones require careful attention to detail and master planning before being developed. Generally speaking, the more comprehensive the planning process, the more likely the Free Zone is to succeed.

Important components of the planning process include:

- ✓ Market Analysis
- ✓ Existing Conditions Analysis
- ✓ Land Use and Development Plan
- ✓ Legal and Regulatory Framework
- ✓ Business Plan

After the planning process, many implementation options are available including competitive tendering, sole source awards, and build-operate-transfer (BOT) development. The type of development option depends substantially on the result of the planning process, and follows naturally from it.

An important part of the Free Zone planning and construction process is managing the varied consultants and firms which contribute to the project. Few governments or ministries have the experience or resources necessary to accomplish the task. Creative project integration and expert management skills are needed to complete complex economic development projects such as Free Zones.

Most countries develop Free Zones as a means of improving the local economy, becoming stronger participants in world trade, and becoming respected members of the international community. Methods of developing a Free Zone must be as individual as the country itself. Understanding the motivators and catalysts of change, and the best means of using them, is important in developing the Free Zone plan. Adoption of any development technique must be done with caution so that appropriate strategies will be selected for use.

It is recommended that a knowledgeable Free Zone consultant work with the government considering development of a Free Zone.

The international Free Zone consultant can:

- ✓ Assist the government in developing appropriate Free Zone goals using local resources and competitive advantages.
- ✓ Develop and implement a plan for achieving goals.
- ✓ Assist the government in developing policies, laws and guidelines.
- ✓ Assist the government in obtaining multilateral bank financial assistance for planning and structuring a Free Zone.
- ✓ Identify and recruit developers, constructors and private investors and lenders.

The Meneren Corporation (TMC) is aware of the promise and pitfalls of Free Zone development. Sustainable Free Zone development is dependent on the appropriate mix of policy, technology, and investment. TMC is available for all areas of Free Zone consultancy including planning, development, and program management.

The Meneren Corporation has experience in the planning and development of the following free zones:

- **Jebel Ali Free Zone, United Arab Emirates**
- **Ras Al Khaimah Free Zone, United Arab Emirates**
- **Aden Free Zone, Republic of Yemen**
- **Quito Airport Free Trade Zone, Ecuador**

The Meneren Corporation Planners & Developers of Successful International Projects



- **Seaports** - Expansion, Modernization, Privatization, Security
- **Airports** - Conversion, Expansion, Privatization, Security
- **Toll Roads** - Development, Conversion, Privatization
- **Free Zones** - Commercial, Legal and Legislative Planning & Development
- **Support Systems** - Power, Water, Waste

- Technical & Commercial Project Evaluations
- Strategic Program Planning & Project Mgmt
- Public-Private Venture Development
- Consortium Selection & Team Building
- Project Financing (Debt & Equity)
- Int'l Grant, Credit, and Subsidy Assistance
- Development Agreements and Contracting
- Government Procurement Assistance
- Integrated Security Systems



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