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FREE TRADE ZONES IN THE AFTERMATH OF THE URUGUAY ROUND: EXPERIENCE OF SELECTED OIC MEMBER COUNTRIES

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The scope of the Uruguay Round extended beyond the traditional issues covered in previous multilateral trade negotiations, which primarily addressed the reduction of barriers against trade in goods at country borders. Sectors of particular and priority concern to developing countries were included in the negotiations related to the evolving international structures of production and trade, including the movement of capital in the form of foreign investments. The outcome will significantly influence the patterns of trade, competition, production, investment, domestic regulations and so on. In the light of the UR regulations, the paper attempts to assess the compatibility and competitiveness of free trade zones as modalities used by developing countries for promoting foreign investment, expanding exports, generating technology transfer and employment, and facilitating transitions to more liberalised open economies. Special attention is given to free trade zones in selected OIC member countries.

1. INTRODUCTION

Over the years, trade policies and trade regimes have been fundamentally transformed in a number of ways at the national, regional and global levels. **Free trade zones (FTZs)** were probably one of the oldest modalities designed to facilitate the development of international trade. It is, therefore, logical to expect that such zones would develop and succeed at a time when world trade is expanding, and in places on or close to international routes like ports, airports and railway junctions. The FTZ concept has been modified and adjusted in many ways over the years. Depending on the purpose for which they are created and on the functions they perform, many different FTZ styles were developed. The original FTZ idea was adapted to accommodate offshore processing. Later, new sites for commercial, manufacturing and services activities were also developed as free zones. FTZs have begun to play a prominent role in international trade only since the early 1970s. Many developing countries have adopted such programmes in the last three decades as policy instruments for promoting foreign investment, expanding exports, generating technology transfer and employment, and facilitating transitions to more liberalised open economies.

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Among the reasons why developing countries adopted FTZs programmes were the growing realisation that import-substitution policies did not lead to the development of an efficient manufacturing sector, and the attention received by the success stories of FTZs in countries such as Singapore, Hong Kong, Panama, Ireland, Taiwan, Korea, Malaysia, the Philippines, the Dominican Republic and Mauritius.

At the same time, many significant changes have taken place in the world trading system over the years. The recent successful conclusion of the Uruguay Round (UR) of multilateral trade negotiations in December 1993 has produced the most fundamental reform of the world trading system since the establishment of the General Agreement on Tariffs and Trade (GATT) in 1947. It introduces disciplines into a wider coverage of products and countries and testifies to a wider and deeper commitment to trade liberalisation. The scope of the UR Agreements extends beyond the traditional issues covered in previous multilateral trade negotiations, which primarily addressed the reduction of barriers against trade in goods at country borders. Sectors of particular and priority concern to developing countries were included in the negotiations related to the evolving of international structures of production and trade, including the movement of capital in the form of foreign investments. The outcome will significantly influence the patterns of trade, competition, production, investment, domestic regulations and so on. Perhaps the most important outcome has been that the range of measures previously viewed as falling within the scope of domestic policy have now been brought under multilateral discipline and linked to the rights and obligations governing international trade and market access.

This, undoubtedly, would forcefully entail some policy measures to be taken by developing countries to accommodate and secure their commitments to the new system. The nature of these policy measures will very much depend on the present foreign trade policies and structures of their economies. There is an urgent need in developing countries to review and assess their present strategies and policies, reform their inward-oriented direction and introduce far more radical changes to improve the international competitiveness of their trade and industries. One of the key elements critical for the effective implementation of such reforms and improvements is to design appropriate policy and administrative instruments and measures that are suitable for the particular conditions of their economies as well as for the new setting of the international trade system.

In this context, experience of FTZs around the world, however, shows that free zones are far from being a panacea. In fact, many countries have experienced mixed results with free zones programmes. The FTZ modality has

not always produced the expected benefits. Many zones have not lived up to expectations, and in several cases have resulted in outright failures, often because of unsuitable location and poor infrastructure combined with ineffective management and an inappropriate policy environment. One must, therefore, exercise caution in assessing the potential of these modalities, especially at a time when the world trading system is now going through a fundamental reform towards a wider and deeper multilateral commitment to trade and manufacturing liberalisation. The many lessons that have been learned, both from failures and successes, should be made use of by those interested in the potential use of such modalities in order to maximise the many development goals they are capable of generating.

This paper attempts to assess the potential for compatibility and competitiveness of FTZs in the aftermath of the UR as a modality used in developing countries for promoting foreign investment, expanding exports, facilitating technology transfer and generating employment, and facilitating transitions to more liberalised open economies. In addition to the present introductory section, the paper comprises five other sections. Section two provides a brief discussion of the definitions and historical background of the various FTZs modalities. Drawing upon theoretical considerations as well as the experience already gained from both failures and successes around the world, Section Three presents a general assessment of FTZs programmes as trade and industrialisation modalities used in developing countries over the last three decades. Considering some related issues of concern in the UR agreements, Section Four attempts to assess the potential for compatibility and competitiveness of FTZs in the future. Section Five provides and examines different examples of experience with FTZs in selected OIC member countries. The paper ends with Section Six, which provides some concluding remarks.

2. FTZs' MODALITIES: BACKGROUND AND CONCEPTS

There is no consensus among economists as to what to call this general phenomenon. The concept of "***Free Trade Zone***" has been modified and adjusted in many ways over the years and has been expressed in the literature by more than twenty different terms. The various terms are grouped under five headings in Appendix-1. All these terms, except *maquiladora*, include the word **zone**. However, the most popular ones are: *free port* (**FP**), *free trade zone* (**FTZ**), *export processing zone* (**EPZ**), *export processing regime* (**EPR**), *special economic zone* (**SEZ**) and *free zone* (**FZ**). In general, the term "**Free Zone**" (**FZ**) is often used to refer to free trade zones (FTZs), export processing zones (EPZs) and special economic zones (SEZs) as a group.

The original FTZs idea was adopted as commercial centres to accommodate offshore processing. Special zones were created at ports or international trade routes to facilitate the movement of merchandise. They represented essentially stopover points for storage, repackaging, labelling and other simple operations for the purpose of re-exportation. Therefore, **Free port** (**FP**) was probably the first term used. It refers to zones established in the eighteenth and nineteenth centuries by the colonial and industrial powers on major trading routes. The first such port was Gibraltar (a British colony in Spain), established around the year 1705. Other ports were established also by the British in the nineteenth century in Aden, Singapore and Hong Kong. In Africa, the French made of Djibouti an important free port and trading centre. After the Suez Canal was opened in 1964, Port Said became one of the busiest free ports. On the other side of North Africa, Tangier, Morocco, prospered as a major commercial centre and free port for centuries. In Europe, the best known free ports are Rotterdam and Hamburg, both of which developed in the second half of the 19th century.

"**Free Trade Zones**" (**FTZs**), known also as 'commercial free zones', can be defined as designated areas, physically or administratively located outside the national customs territory, in which unrestricted trade is permitted with the rest of the world (usually set aside within port areas and at other major transport intersections, mainly road and rail). Merchandise may be moved into and out of these zones free of customs duty, stored in warehouses for varying periods and re-packed for re-export and trans-shipment. The emphasis in these zones is on trade and trans-shipment. Some of them are used exclusively for trans-shipment to neighbouring inland countries. The port of Karachi, for example, has a small transit zone to store goods destined for Afghanistan. Other zones, particularly free ports like Singapore and Rotterdam, are major intercontinental trade and distribution centres. FTZs operations remained essentially commercial activities, and were not thought of as main locations for manufacturing industries exporting their goods or serving domestic markets. The adaptation of the FTZ concept to serve the purpose of facilitating the operations of import-dependent export industries was developed around 1960 with the establishment of export processing zones, the successor of the FTZ concept.

The concept of "**Export Processing Zone**" (**EPZ**) can be defined as special areas within which foreign or domestic firms may manufacture or assemble goods for export without being subjected to the normal customs duties on imported raw materials or exported products. Frequently, firms occupying the zones also receive special treatment in the leasing of land for their factory sites, purchase of utilities such as electricity, and exemption from other regulations normally applying to firms within the domestic economy. The

first EPZ was established in 1959 at Shannon Airport in Ireland. At that time, the Irish government, concerned with its stagnating industrial base and weak performance in employment and investment generation, offered special incentives to assembly and manufacturing operations willing to locate in Shannon and export from Ireland. These incentives, combined with relatively low labour costs, sound infrastructure, and proximity to the West European market, allowed Ireland to experience an economic revival. In the last three decades, EPZs have spread rapidly throughout much of East and South Asia, Africa, the Caribbean and Central America. A number of west European countries, including France and England, have also embraced the idea. At present, most former socialist countries in Europe and Asia, as well as many countries in Africa and South America, are examining the concept. When the concept of the EPZ is applied to include the whole territorial area of the country, it becomes "**Economic Processing Regime**" (**EPR**). This term refers to an administrative rather than a physical concept. EPRs exist, for example, in Mauritius and Fiji. In such countries, investors, both domestic and foreigners, are not confined to a particular zone. If they have EPR status, they can set up their facilities anywhere and have the same privileges and status as investors in EPZs do in other countries. This means that they can import inputs and equipment free of duty, process the materials and export the finished products. The *maquiladora* sector in Mexico and the enclave sectors (EPZs) in Barbados could also be classified as EPRs.

Another term used recently to refer to zones similar to EPZs is the term "**Special Economic Zones**" (**SEZs**). The concept has been associated with developments in China since 1980. The Chinese government recognised the need for special measures to attract foreign capital, technology and management. In 1980, the government started with two zones in which local authorities were allowed to adopt local legislation and regulations for promoting foreign and local investment. There were favourable tax and operation procedures, including duty-free imports of materials and equipment. Most of the output was exported, although up to 30% of local sales were allowed. In 1984, the concept was extended to 40 coastal and inland areas in China, reflecting a general satisfaction with the concept (UNCTAD, 1985). The idea of SEZs is to develop limited geographic areas as centres for foreign and domestic export-oriented investment. The zones should have good infrastructure, a simplified regulatory framework and a range of support services. The primary emphasis in these zones is on creating a pro-business environment and freedom from bureaucracy. More recently, the concept has also been used in proposals for free zones development in Eastern Europe. Feasibility studies are being planned or carried out for the development of SEZs in Poland, Romania, Bulgaria, Hungary, Slovakia, the Russian

Federation and a number of other member states of the Commonwealth of Independent States.

Experience has shown that sponsoring countries have recently found some FTZs styles, in particular EPZs and SEZs, to be greater sources of employment generation, foreign exchange earnings, and transfer of technology. In the mid-1980s, some 70 countries around the world were operating a total of about 400 such zones--half of which was established in developing countries and employed 1.5 million workers with annual average exports ranging between $13 billion and $15 billion. The geographical breakdown of employment and exports, respectively, in percentage terms among the zones was as follows: Asian zones, 63% and 65%; Latin American and Caribbean zones, 32% for both employment and exports; and African zones, 5% and 3% (UNCTAD, 1992, p. 4). In the early 1990s, more than 90 countries worldwide have established EPZs programmes. These programmes accounted for an estimated $30 billion in annual exports and employed almost 4 million workers (approximated figures based on different sources). Such aggregate figures are impressive, especially if one considers that they were accumulated over relatively short periods of time. As such, the discussion in this paper is concerned mainly with this group of free zones, although, hereinafter, the term **FTZs** will be used as a general reference assuming that all other types of free zones are included.

3. FTZs AS TRADE AND INDUSTRIALISATION MODALITIES IN DEVELOPING COUNTRIES

The concept of FTZs as a policy instrument has originally been used in developing countries to initiate and promote export-oriented development. However, although FTZs seem to have an extensive history, it is only since the early 1970s that they began to play a prominent role in the development of these countries. Over the last two decades, FTZs have become an important part of the efforts of many developing economies to attract foreign investment and increase their manufacturing exports. During the 1970s, some of the rapidly industrialising countries, especially in East and South East Asia, have included FTZs programmes, particularly EPZs, among the package of policy measures designed to attract foreign investment in manufacturing. They had the economic policy environment, infrastructure and cost structure required for foreign, export-oriented, direct investment in manufacturing. The emphasis on such a strategy in these countries stemmed from two main reasons: (a) the early and apparently successful examples of Taiwan and the Republic of Korea, who began experimenting with EPZs during the mid-1960s and the early 1970s, respectively; and (b) the growing realisation that protectionist policies, in particular import-substitution policies, discouraged the development of export

industries to exploit the country's comparative advantage and did not lead to the development of an efficient manufacturing sector in developing countries. FTZs were thus seen as useful modalities of developing efficient export industries in countries which have the basic conditions for the successful operation of an export industry, but lack the technical or administrative capacity to develop a country-wide regime for importing raw materials and equipment duty-free. In recent years, there has been a growing interest in FTZs, particularly in Least-Developed Countries (LDCs), as modalities for helping them overcome their inability to generate an outward supply response and provide immediate employment, as well as foreign exchange earnings, by inducing foreign direct investment (FDI). This reflects changing perceptions in developing countries about the critical role of close collaboration between foreign and domestic enterprises by taking advantage of the increasing globalisation of manufacturing and trade.

Trade theorists have responded to the proliferation and the increasing use of FTZs, particularly in developing and least-developed countries, with a large literature since the mid-1970s. However, it is noteworthy, in this regard, that although the traditional theory of comparative advantage argues that the movement of production factors from one country or region of relative richness to another of relative scarcity is of benefit to both, most trade theorists in the 1970s and 1980s have argued that FTZs, in particular EPZs, have a negative or, at best, a very limited positive effect on the economy of the host country (see Johansson (1994) for an overview of the literature). Hamada (1974) wrote the first major theoretical article explicitly discussing FTZs using tools of international trade theory. He analysed the effects of opening up FTZ within a two-by-two Heckscher-Ohlin model of a labour-abundant country that imports capital-intensive goods. In his model, Hamada assumed that FTZs generate an inflow of foreign capital attracting, thereby labour from the domestic economy. The main theme in his analysis is that the welfare effects of the FTZs depend on the factor intensity of the protected sector in the host country. In other words, when the protected sector is capital-intensive, the movement of labour from the domestic economy to FTZs increases production of the protected sector through the Rybezynski effect, thereby reducing welfare. On the other hand, if this sector is labour-intensive, the output of the protected sector falls while welfare increases. Many other trade theorists have later followed Hamada's approach in their work on FTZs, especially in the 1980s (see for example Hamilton and Svensson (1982), Miyagiwa (1986), Young (1987, 1992), Miyagiwa and Young (1987) and Warr (1989)). They have used more complex models with unemployment and imported intermediate goods. However, none of these extensions have altered Hamada's result that the welfare effects of FTZs are determined by the factor intensities of protected sectors in the host countries. Recalling that protected sectors in developing

countries are often typically capital-intensive, it is not surprising, then, that these theorists have concluded that FTZs are welfare-reducing policy instruments. However, an exception in the 1980s is Spinanger (1984) who argues that under certain conditions of integrating into an appropriate policy framework, FTZs can represent efficient industrialisation policy measures, and gives evidence from some Asian countries like Singapore, Taiwan and Malaysia.

More recently, Devereux and Chen (1995) have argued, using the same theoretical framework of factor intensities used by the above-mentioned theorists in the 1980s, that in many cases FTZs improve welfare and increase the likelihood of a trade liberalisation regime in the host country. Considering the results of such studies and the fact that FTZs are still an increasingly popular trade and industrialisation instruments all over the world, there are, thus, reasons to believe that an important beneficial effect of FTZs has been overlooked in most of the studies carried out in the 1980s. In fact, although a full-blown theoretical treatment of the impact of FTZs has yet to be produced, several trade theorists have recently argued along these lines and discussed the potentially important indirect effect of FTZs on the economies of the host countries, particularly in the developing and least-developed countries. At the centre of their discussion is the degree to which firms, attracted to those zones and set up in them, will be able to develop linkages with producers in the host country and help extend the given industrial base in the domestic economy. This is of course in addition to generating labour income and foreign exchange. Beyond such direct influences, the question is also raised about the ability of FTZs to pass along technology and know-how to the domestic economy in a form which can be combined with factor endowments to effect changes in the economic structures.

In this context, traditional trade theory often assumes that once trade-related constraints in any country have been removed, a resulting export supply response will instantaneously come from the domestic economy (local firms) and foreign investors. But this may not always be the case, especially in LDCs. With little or no export experience, the domestic firms in these countries may have problems in entering into the world markets, especially with non-traditional (manufacturing) exports. They often lack “export know-how” not only in the technical sense, but also in terms of marketing and managerial competence. In order for these countries to enter the world markets, they need to make large gains by exploiting the technical, managerial and marketing ideas developed in other countries. An important channel for this transmission is FDI made by foreign enterprises. Since FTZs are intended to attract FDI through foreign enterprises and use foreign know-how and capital to create an export base, local firms may be stimulated to enter the export market by

learning from the experience of foreign enterprises in these zones. It is thus possible that foreign firms in FTZs could have an indirect or dynamic positive effect in the long run on the domestic economy of the host country. In fact, such a potential effect has largely been overlooked in the literature on FTZs in the past. As a consequence, the success of FTZs has mainly been judged in terms of the direct or static effect, in the short run, of such factors as employment creation, export expansion, and foreign exchange earnings on the domestic economy of the host country.

From this perspective, Johansson and Nilsson (1997) argued that foreign firms attracted to the FTZs have a significant **catalyst effect** on the economy of the host country through stimulating local firms to export by showing them how to produce and distribute their manufactured goods in the world market. They argued that for a FTZ to have a catalyst effect on the host country, some basic features are required, including both key micro characteristics of the FTZ and overall macro aspects such as the general trade and development regime pursued by the host country. They also argued that even though the FTZ may be successful in attracting investment and generating export earnings, it is not automatic that the export supply response will spread outside the zone. If the protectionist trade policy situation remains in the rest of the country, foreign firms may have a positive influence on domestic firms within the zone but fail to stimulate the firms outside it. Their results have shown a significant catalyst effect of FTZs in Malaysia. The Rhee and Belot (1990) study of individual, non-traditional, manufacturing industries in 11 developing countries and the circumstances behind their successful entry into the world market provided some support for Johansson and Nilsson's (1997) hypothesis. Their finding was that in almost every case, a particular firm or public agency played a critical role in the initial export phase by combining local endowments with managerial experience, marketing knowledge and relevant technology. In industries where the country in question had little or no previous experience, this role was often played by a foreign enterprise. This was especially true for the least-developed countries.

However, due to the various purposes of their foundation and, thus, due to the various functions they perform in order to maximise the development goals they are capable of generating, it seems very difficult to measure the success of FTZs programmes. Traditionally, the performance of these zones is measured by the volume of investment, both foreign and local, which these zones are able to attract; e.g., the numbers and types of firms operating in the zones and/or the value added created by the firms in the zones. In addition to this major criterion, there are also other important measures related to the relationship between the zones and the domestic economy. These include the opportunities for generating employment, foreign exchange earnings, and

exportation, the number of workers employed in the zones, and the value of the zones exported products. Another important, but difficult to measure, criterion is the extent to which the zones are used as instruments for generating technology and management skills transfers, and facilitating transitions to a more liberalised open economy. Yet, the lack of the necessary detailed information and data on all these indicators in most of the FTZs programmes adds to the difficulty of assessing the successfulness of these programmes as policy instruments. Fortunately, many lessons have been learned, both from failures and successes. Countries interested in the potential use of such programmes should make the most of those lessons.

A 1992 World Bank study on 86 EPZs operating in 27 developing countries could only provide a rough assessment based primarily on the number and type of investors that these zones have attracted, the direct employment they have achieved, and information on their exports, occupancy, unusual costs, and problems. As indicated in the study, this was mainly due to the fact that the detailed information necessary to make even an imperfect cost-benefit analysis was available for only a few zones. Based even on such rough criteria, according to the same study, about 40 to 50 percent of these zones have appeared to be successful, 20 to 30 percent partly successful, and about 30 percent unsuccessful. The study also indicated that about half the zones in Asia (accounting for 71% of the zones employment), several zones in the Dominican Republic (accounting for 21% of the zones employment), not more than two to four in the rest of Latin America and the Caribbean were successful. But none of the zones in Africa or the European and Middle East Regions was successful.

According to this study, perhaps the first successful story goes back to the first modern EPZ established in 1959 at Shannon Airport in Ireland. Ireland's success was quickly copied by a number of Asian countries. Taiwan was the first, establishing its first EPZ in 1966. Other East Asian countries, influenced by Taiwan's success, quickly followed suit. Malaysia and South Korea established FTZs programmes in the mid-1970s. FTZs proved also to be successful in certain countries of the Central American and Caribbean regions. The Dominican Republic presents one of the more noteworthy examples. Other successful FTZs sponsors in this region include Costa Rica and Jamaica. African countries have also gained experience with FTZs programmes. The EPZ programme in Mauritius has been the most notable success. In the early 1990s, several other African countries established FTZs programmes following Mauritius' success. However, while preliminary results were encouraging in the cases of both Kenya and Madagascar, for instance, other countries, such as Senegal, Liberia and Zaire experienced great difficulties. Latin America had its own share of problems. Colombia, for example, suffered three outright FTZ

failures between 1975 and 1992. Guatemala's publicly administered EPZ encountered problems of stagnation, while Costa Rica's two publicly administered zones never attracted significant numbers of firms. Interestingly, both Guatemala and Costa Rica possessed other EPZs that succeeded, but in these cases the primary difference was that these were privately owned and administered. In this regard, it is worth mentioning that African free zones have also encountered problems due to public administration, while in Asia, publicly administered zones fared quite well.

These few examples show that FTZs programmes are not always a guaranteed mechanism for achieving the various goals for which they are commonly considered. Many countries have experienced mixed results and some suffered outright failures, often because of unsuitable location and poor infrastructure combined with ineffective management and inappropriate economic policy environment. Great difficulties with FTZs were experienced, especially in the early 1970s, when economies were experimenting with these programmes; some employed only a couple of hundred people while others were engaged in activities such as warehousing, oil supply or financial services, far from the original FTZs intention. It has been observed that the performance of publicly owned and administered zones was disappointing, except in Asia where the majority of FTZs are public, and a few in Latin America and the Caribbean. The successful public FTZs in Asia work in part because they have been managed flexibly with profit making as an objective (Johansson and Nilsson, 1997). In some cases, mistakes were made due to the incorporation of regional development objectives into the FTZs investment decision. Policy makers saw in some cases the possibility of establishing FTZs in rural, underdeveloped areas as a way of promoting more balanced economic development in the country. The Bataan EPZ in the Philippines was established in 1972 and is a typical example of failure because of regional development objectives and the subsequent poor location, far from major cities and main transportation routes (Warr, 1987a). Moreover, it has been observed that although FTZs are common in developing countries, a relatively large number of them exist only on paper, have never taken off or have been abandoned by investors due to the lack of economic and political stability in host countries (Johansson and Nilsson, 1997).

Experience with FTZs around the world suggests that several factors affect the success or failure of these programmes. The majority of these factors are micro-characteristics commonly shown by the zones and/or dependent on the readiness and preparedness of the host country to adopt such programmes. The particulars and relative importance of these factors vary from region to region, from country to country, and also in accordance with the functions of the free zone. These factors may be summarised in the following 10 points:

1. Political and economic stability of the host country.
2. Guaranties against nationalisation or expropriation.
3. A reliable foreign investment policy based on the host country's reliability in international economic relations and its attitude with regard to the system of international arbitration.
4. Proximity of the host country to major world markets.
5. Cheapness of some factors of production in the host country.
6. Quality and suitability of such services as banking, shipping, and consultation.
7. Availability and adequacy of infrastructure and superstructure in the zone.
8. Ability to compete with other free zones in the region, and the avoidance of any adverse competition with the domestic economy of the host country.
9. Ability to obtain as many factors of production used in the zone as possible from the domestic economy.
10. Ensuring, at all times, the cost/benefit feasibility of establishing and maintaining the free zone.

Although the actual policies governing FTZs differ in detail among developing countries, experience shows that the successful free zones programmes in 1980s share some common characteristics. This is in addition to such features as a favourable location, promotion and adherence to the basic principles of duty-free importation of inputs, minimal administrative procedures and adequate support infrastructures. The characteristics include the following: (a) all or most commodities produced in FTZs are export-oriented, that is, they are directly exported without entering the domestic markets. The Malaysian government, for instance, requires that at least 80 % of zone-manufactured goods be exported. In Taiwan, the export requirement ratio is 100% (Spinanger, 1984). (b) Exports from FTZs are typically non-traditional manufactured goods: the Santa Cruz Electronics Export Processing Zone in India, for example, is specialised in electronic products; and (c) in order to increase employment, developing countries generally prefer the zone-based firms to be relatively labour-intensive. For instance, no firms are permitted to operate in the Kaohsiung Export Processing Zone of Taiwan unless their labour costs exceed 20% of the total costs (Spinanger, 1984).

Yet, many questions are raised about the relationships between FTZs policy regime and overall economic policy reforms in developing countries and about the compatibility and competitiveness of FTZs in the future. Those questions open the way for further important research, especially at a time when the world trading system is going through a fundamental reform towards a wider and deeper multilateral commitment to trade liberalisation and globalisation of manufacturing. The following section attempts to highlight some of the issues likely to influence the compatibility and competitiveness of

FTZs in the aftermath of the UR Agreement and the establishment of the World Trade Organisation (WTO) and in the light of the globalisation process in the world economy.

4. FTZs IN THE AFTERMATH OF UR/WTO RELATED ISSUES OF CONCERN

Trade policies and trade regimes have been fundamentally transformed in a number of ways over the last three decades, and, consequently, many significant changes have taken place in the world trading system. Such a mechanism, along with the rapid technological progress in communications and patterns of production, has accelerated the pace of change in the world economy. During the past decade, the world economy has experienced an increase in and an intensification of economic ties among national economies through cross-border flows of goods, services, investment and factors of production. This process which has been referred to by economists as "globalisation" describes the challenges of governing an increasingly complex pattern of cross-border linkages and closer links between different markets and production structures. The manifestations of globalisation include the movement towards the internationalisation of production patterns, the moving of industries across borders, the speed of financial markets, the diffusion of identical consumer goods to distant countries, and the spread of multinational companies. Globalising the world economy will bring about many consequences, and one of them is already clear: an emerging economic world without borders in which information travels across national borders at ever-increasing speeds. In such a world economy without borders, consumers are becoming global in orientation. In other words, they choose the best and cheapest products irrespective of their origin.

Consequently, in order to be competitive, industrial production must not be limited or restricted to national borders. In such a setting of a rapidly changing world economy, competitiveness, productivity, skilled labour and management capacity become more and more important elements of economic development. This challenge will, no doubt, have far-reaching impacts on the economic and trading interests of developing countries, as well as on the multilateral trading system as a whole. Such a setting necessitates and assumes greater determination, adaptability, interdependence, and closer co-operation and collaboration among different economies and regions. This, of course, will exert intense pressure on developing countries to reform their inward-oriented economic policies. It will therefore urge them to review and assess their present trade and production policies and introduce far more radical changes that will allow them to cope more effectively with the new setting of the

multilateral trading system and improve the international competitiveness of their trade and industries.

The successful conclusion of the UR of multilateral trade negotiations in December 1993 has produced the most fundamental reform of the world trading system since the establishment of the General Agreement on Tariffs and Trade (GATT) in 1947. It introduces disciplines to a wider coverage of products and countries and testifies to a wider and deeper commitment to trade liberalisation. The establishment of the World Trade Organisation (WTO) on 1 January 1995 to draw up and administer the basic rules of international trade will contribute to a necessary strengthening of the global trading system. This will be achieved through stronger procedures for settling disputes, a mechanism for reviewing country trade policies, and greater involvement of member countries in decision-making.

The scope of the UR Agreements extended beyond the traditional issues covered in previous multilateral trade negotiations, which primarily addressed the reduction of barriers against trade in goods at country borders. Sectors of particular and priority concern to developing countries were included in the negotiations related to the evolving international structures of production and trade, including the movement of capital in the form of foreign investments. The UR Agreements went far beyond what had been achieved in previous rounds in terms of involving developing countries in the multilateral trading system, extending disciplines to agriculture and services, and covering new aspects of trade such as trade-related intellectual property rights (TRIPs) and trade-related investment measures (TRIMs).

In general, the UR agreements can be classified into three groups: (1) those related to traditional GATT issues such as tariff liberalisation, subsidies, dumping, government procurement, technical barriers to trade, dispute settlement and institutional reform; (2) those covering areas that had initially been covered by standard GATT rules but became excluded from GATT discipline for several reasons, namely, agriculture and trade in textiles and clothing (Multi-Fibre Arrangement MFA); and (3) those dealing with new issues not previously covered by the GATT, especially TRIPs, TRIMs, and the General Agreement on Trade in Services (GATS). In the following, we shall describe in brief the main features of the UR Agreements in relevant areas of new rules which are very likely to influence the compatibility and competitiveness of FTZs as modalities used in developing countries over the last two decades for promoting foreign investment, expanding exports, generating technology transfer and employment, and facilitating transitions to more liberalised open economies.

(1) *Provisions on Trade in Industrial Goods.* The reductions in the protection provided to manufactures were generally substantial, with deep tariff cuts and the outlawing of important non-tariff barriers. Tariffs on manufactured imports into industrial countries were reduced from a trade-weighted average of 6.3% to 3.8%, a cut to be phased in over five years. For industrial countries, tariffs were reduced by an average of 45% on imports from other industrial countries and by 30% for imports from developing countries. For developing countries, the reductions in tariff rates on manufactures averaged 28% on products from industrial countries and 29% on those from developing countries. Commitments under the UR Agreements take the form of bindings in which the proportion of industrial countries' tariffs on industrial products subject to bindings rose from 94% to 99% as a result of the Round. The proportion of developing countries' imports of industrial products subject to bindings rose from 13% before the Round to 61% after it (Martin, W. and Winters, L. 1995). So, the dramatic increase in tariff bindings in manufacturing, both in developed and developing countries, intensifies the importance of the global trading system for regulating national trade policy.

Besides the reduction in tariffs, a key feature of the UR was the substantial progress made in dealing with the non-tariff barriers on industrial products in most industrial countries (the so-called 'grey area measures') such as voluntary export restraints (VERs) and the Multifibre Arrangement (MFA). VERs must be abolished within four years and the MFA is to be phased out over ten years. The clarification of rules and the strengthening of discipline in a number of areas (e.g. safeguards, subsidies and countervailing measures, anti-dumping measures, etc.) will prohibit or, at least, limit the use of non-tariff measures. Therefore, the gradual elimination of the grey area measures by industrial countries will increase the export opportunities of developing countries. Thus, in the post-UR period, with tariffs and non-tariff barriers to trade at historical low levels, public and private enterprises will be subjected to greater international competition.

(2) The *General Agreement on Trade in Services* (GATS). An important feature of the framework of this Agreement is that it not only covers cross-border trade in services, but services supplied by foreign firms within a country to consumers in that country and services supplied by domestic firms to foreign consumers who are visiting the country. This agreement commits WTO members to a set of general principles that includes most-favoured-nation treatment, transparency with regard to any domestic laws or regulations affecting trade in services, and progressive liberalisation in the services area. The key part of this agreement consists of schedules of commitments by WTO members in which they set down specific terms and

conditions on market access, conditions and qualifications on national treatment, and the time frame for implementing such commitments. In this regard, it is noteworthy that while most countries made commitments not to impose new restrictions against foreigners, there was a lack of significant liberalisation in such important sectors as financial services, transportation, and telecommunications. Thus, the most important accomplishment has been to bring the services sector under international trading rules and set the stage for later significant liberalisation.

(3) The *Agreement on Trade Related Aspects of Intellectual Property Rights* (TRIPs). The agreement made a substantial progress in overcoming the drawbacks of the existing system of patents, copyrights and trademarks operating under the jurisdiction of the World Intellectual Property Organisation (WIPO). All WTO members are now required to provide copyright, trademark and patent protection for a specific number of years on the goods and services covered under the agreements to which most developed countries adhere. The provisions of this Agreement must be implemented within a year after the date of entry into force, but developing countries and countries in transition are given another four years, while LDCs need not apply the agreement's provisions for ten years. In addition, if a developing country is obliged to provide patent protection in an area not currently covered by its laws, it may delay implementation of this protection for another five years. Specific enforcement procedures are also contained in this Agreement. For example, countries are required to establish civil judicial procedures whereby individuals and firms can seek to enforce their intellectual property rights. A Council on Trade-Related Aspects of Intellectual Property Rights is established to monitor the compliance of countries with their obligations under the Agreement. The Agreement represents an important step in encouraging Research and Development (R&D) by private firms. However, the industrial countries, where most R&D activities take place, will clearly gain. While some developing countries will also gain in the long run as they begin to develop new technologies themselves, many are likely to lose in the short run. This is why developing countries have been given the five-to-ten-year-period within which to implement the various provisions of the Agreement.

(4) The *Agreement on Trade Related Investment Measures* (TRIMs). An economically efficient global economy requires that direct investment among nations should be as free from burdensome border and domestic controls as the movement of goods and services. However, there are still many countries that restrict FDI in various ways and also impose performance requirements on foreign firms operating in their territories. Negotiations on trade-related investment measures, therefore, aimed at

eliminating trading requirements imposed on foreign enterprises but not on domestic firms within a particular country. By specifying that the principle of national treatment must apply to foreign firms, such practices as requiring foreign enterprises to purchase a certain proportion of domestically produced goods and services or export a certain proportion of their output have become illegal under the TRIMs Agreement. However, developing countries are given five years and LDCs seven to eliminate such measures and can apply for an extension if they encounter particular difficulties in implementing the agreement. In this regard, a number of developing countries, anxious about too much foreign political influence if FDI is not controlled, strongly resisted efforts to deal with this issue in the Round although the TRIMs Agreement does contain a provision specifying that, in the course of reviewing the Agreement within five years, the issue of including provisions on investment policy shall be considered.

It seems very likely that the UR Agreements should significantly strengthen the multilateral trading system through a wider and deeper commitment to trade liberalisation, phase out the remaining barriers to trade, not only in goods at country borders but also in services and capital in the form of foreign investments, and reverse the trend of protectionism and unequal treatment of trading partners that characterised the 1980s. The outcome will, therefore, significantly influence the patterns of trade, competition, production, investment, domestic regulations and so on. It is obvious that almost all the aspects and measures of the UR Agreements are issues very closely related to FTZs programmes. FTZs will, no doubt, be significantly influenced by the outcome of the UR Agreements in different areas in terms of their characteristics, administrative and regulatory measures, the relationships between their policy regime and the overall economic policy reforms in the host countries, and, more importantly, in terms of their compatibility and competitiveness in the future if the application of the UR Agreements proceeds as agreed. Perhaps the most important issue of concern which is very likely to influence the compatibility and competitiveness of FTZs and shape their character in the future stems from the fact that the most important outcome of the UR has been that the range of measures previously viewed as falling within the scope of domestic policy have now been brought under multilateral discipline and linked to the rights and obligations governing international trade and market access.

The major accomplishment of the UR has been to adopt new rules which take into account the fact that the distinction between border and internal trade regulations is becoming increasingly less meaningful for facilitating international transactions in goods and services. Taking this and the globalisation trend of the world economy into account, and once a country

develops an effective economy-wide free trade regime and minimally regulated market mechanisms in accordance with the UR agreements, it is thus logical to expect, in the long run, that FTZs programmes will diminish in importance as modalities for promoting foreign investment, expanding exports, generating technology transfer and employment, and facilitating transitions to more liberalised open economies. This will, no doubt, have a significant negative effect on the compatibility and competitiveness of FTZs in the long run in terms of diminishing the importance of the purposes of their establishment and the functions they perform. Ultimately it will make them increasingly less meaningful in achieving the various goals for which they are commonly considered.

5. THE EXPERIENCE OF SELECTED OIC MEMBER COUNTRIES

As in developing countries, FTZs programmes have been used in many OIC member countries over the last three decades as modalities to initiate and promote export-led development strategies. Considering the different geographical locations, the heterogeneity in the economic structures, and the discrepancies in policy priorities at the national level, it is logical that FTZs established in OIC countries should vary in number, type and level of success. However, due to the lack of necessary detailed information and data on FTZs in many OIC countries, in the following section, we shall provide only a brief overview of the experience with FTZs programmes in some selected OIC member countries in different regions.

1. Egypt

Egypt established an FTZ programme in the early 1970s. Initially, it failed in any appreciable investment, and the problem was exacerbated by the 1973 war. However, the policy-makers continued using the concept, and the free zone programme emerged again as a significant component of the Open Door Policy adopted by the government in the second half of the 1970s. The government passed a new law liberalising free zones (Law No. 43 of 1974), and eventually amended it to make it even more attractive to foreign investors (Law No. 32 of 1977). In all, four public FTZs were established in Cairo, Alexandria, Port Said, and Suez.

Among the various elements and key incentives of the programme were:

-Extraterritoriality within the zones;
-Free and independent handling of currency;

-No income taxes or duties except for a 1% fee over import/export transactions or 3% over value added for companies not engaged in import/export activities (services);
-Complete exemption from customs duties on import machinery, equipment, and goods;
-And import duty reductions for products with Egyptian material content.

Initially, the reformed investment law also permitted companies to establish individual private free zones (inland projects) with a similar package of incentives. However, by the early 1980s, such private zones were no longer permitted.

One of the first issues faced by the Egyptian FTZs authorities was the high level of commercial, as opposed to industrial, companies established within the zones. A majority of them engaged in simple importing and trans-shipment activities, with many exporting to the local market (85% of total free zone exports in the early 1980s). It soon became apparent that such free zone activity generated fewer jobs, did not facilitate technology transfer and failed to generate appreciable foreign exchange earnings. Egypt's programme was further complicated by the public agencies in which each of the four zones was established as a public enterprise, regulated, administered and served by the government's General Authority on Foreign Investment and Free Zones. This resulted in the problems typically found in publicly administered free zone programmes such as lengthy and bureaucratic investment application procedures, inefficient administration of customs, delays in the installation of necessary infrastructure, etc. All in all, and taking together all these factors, the Egyptian model of FTZs is not considered to be practically successful (Mourad, 1981).

However, with the introduction of new economic policies in the late 1980s, the government opted for solutions through adopting the strategy of industrialisation for export. It was decided to establish a series of industrial cities, also known as industrial estates, and to encourage entrepreneurs to invest there. Within this effort, the government passed a few investment laws that provided encouraging incentives, such as a tax holiday of 10 years, reduced import taxes on raw materials and semi-finished products, and a flat rate of 5% as customs duties on the value of imported capital assets used for setting up a project. Moreover, in 1989, the government passed a new law concerning industrial zones (Law No. 230 of 1989) and since then, some industrial zones were designed as "Investment Free Zones". These are considered as being located offshore. Goods and materials imported into a free zone are not subject to import duties or customs regulations. It is also permitted

to have a partial free zone within a project to handle the export portion of the activity. 44 industrial zones are now on the industrial map of Egypt, 19 of which are already established but still being developed and 25 are either under construction or still on the drawing board (Mitwally, E., 1997).

2. Jordan

The Aqaba Free Zone was established in 1973 in order to facilitate trade for goods entering through the Port of Aqaba. The zone became operational the following year, with facilities inside the existing port area for trans-shipments and storage. The Free Zones Corporation (FZC) was established as a government-owned company in 1978 with a broad mandate to develop additional free zones. In 1983, the Zarqa site was established as the second principal free zone in the country. It started operations in 1984. The current legislation codifying and governing the FZC was passed in 1984. This legislation forms the basis for the operation and charter of free zones. Subsequently, implementing regulations governing the movement of goods, approval of projects, fees, and other procedures were decreed. The development of the Aqaba and Zarqa sites has been oriented primarily to commercial transit trade and not to industry. The Aqaba zone functioned as an important adjunct to the port in providing duty-free storage and staging areas for importers and transit operators. The Zarqa site was selected for its location near the major crossroads for highway traffic to Syria, Iraq, and western Saudi Arabia. Both facilities have been used extensively by traders supplying Iraq, whose dependence on the Port of Aqaba and trans-shipment through Jordan increased in the 1980s. Neither zone has developed as an industrial centre, although industrial areas were incorporated into the design of the Zarqa site. By 1990, only seven industrial firms had been established in the Zarqa zone. The Gulf Crisis of 1990-91 dramatically changed the utilisation of Jordan's FTZs. Until 1990, the number of firms operating in the zones and the traffic of goods moved through them had been increasing fairly steadily, reaching 250 firms and a total import/export volume of 328,000 tons. In 1991, however, traffic increased by over 400% due to the Gulf Crisis, and the number of firms increased by over 60%. The greatest increases in firms established and goods traffic occurred in the Zarqa zone. Although the vast majority of this increase in activity was in commercial operations, the number of industrial projects approved also increased from 7 to 17 in 1991 (The Services Group Inc., 1992). Nonetheless, the free zone programme retains a predominantly commercial orientation. Many of the industrial firms within the zone have met with limited success, and are not specifically export-oriented.

Although FTZs have made only a marginal contribution to the industrial development of the country, significant investment in industry, including

export-oriented industry has taken place during the same period in industrial areas zoned by municipalities, but most importantly in the facilities of the Jordan Industrial Estates Corporation (JIEC). For example, by the year 1992, a total of 246 projects were established at the Sahab Industrial Estate, of which 200 are now fully operational; 65 of these firms export a significant portion of their production. In the Amman Industrial Estate which was developed during the 1980s, 347 companies (including 78 Arab, foreign and joint venture companies) were established with more than 400 factories in operation employing more than 14000 workers. Al-Hassan Industrial Estate was established in 1991, and by the year 1997, it had attracted 57 companies from various fields and created more than 2000 job opportunities. In addition, the Irbid Industrial Estate, also developed by the JIEC, has attracted 31 industries since its opening in 1991 (Jordan Industrial Estate Corporation, 1997).

In an attempt both to rationalise the operations of the JIEC and the FZC, as well as link the operations of FTZs and industrial estates, the two organisations had planned to merge. However, the JIEC ultimately refused, citing the lack of economic benefits from the FTZs, and the lack of compatibility of their operations with the industrial estates. Relative to the success of the JIEC projects, the reasons that the FTZs have not attracted industrial development include: (a) inappropriate legislative provisions for industrial operations; (b) ill-defined legal basis of FTZs, resulting in confusion over relations with other legislation and exclusion of goods produced in FTZs from being considered as Jordanian products; (c) inappropriate sites and lack of facilities and services for industrial activity; and (d) insufficiently developed institutional capacity of the FZC, and lack of responsiveness in zone management. Taken together, these factors constitute a wide range of constraints that have prevented the FTZs in Jordan from assuming a more dominant role in the attraction of export-oriented industry (The Services Group Inc., 1992).

3. Malaysia

In the early 1970s, seeing the manufacturing success of Singapore and Hong Kong and of the EPZs in Taiwan (China), the Government pushed hard to set up FTZs, particularly, EPZs with a view to promoting the development of the country through the encouragement of export-oriented labour-intensive manufacturing. A law on FTZs has been put into effect in 1971 that called for zones to be developed and managed by the State government. The most successful zones developed by the State include Penang, Selangor (which includes Kuala Lumpur), and Melaka (Malacca). The first zone (near Penang's Bayan Lapas airport) began exporting in 1972, followed quickly by several others. By 1975, eight zones were in operation, and others soon joined them. With the exception of one or two, the 13 EPZs created in the first 15 years

(from 1972 to 1987) have proved a success because of good infrastructure and a favourable business and political environment (The World Bank, 1992). During this period, Malaysia isolated the EPZs from the rest of the economy and, therefore, ignored backward linkages. The government became more active in trying to develop new industries, raise protective tariffs and increase their dispersion. Duty exemptions were given only exceptionally until reforms were made in the late 1980s, and as in most developing countries, the drawback of FTZs is that they have never worked well. However, the importance of EPZs in Malaysia is unique among the developing countries establishing these zones. In 1982, these zones accounted for more than half of Malaysia's total exports of manufactured goods. By that time, Malaysia had become the world's largest single exporter of electronic components, of which the FTZs accounted for 90% (Warr, P.G., 1987b).

A second and related aspect of Malaysia's export promotion policy has been the introduction in 1975 of administrative facilities to permit the production of manufactured goods within customs-bonded warehouses. Firms wishing to use this provision must apply for Licensed Manufacturing Warehouse (LMW) status. The LMW programme has much in common with the FTZs in which imported raw materials and capital equipment used in the production of manufactured exports enter the country duty free. In effect, the firm itself becomes a bonded warehouse and customs officers are located at the factory site to ensure that none of the raw materials and capital equipment which enter the country under the duty free provisions are disposed of on the local market. The LMW programme had less success than FTZs since the policy environment was difficult to improve outside the zones and the provisions were difficult to enforce on a decentralised basis. The system continued to grow, however, and by the year 1992, 151 firms using the LMW programme were employing 75,000 people, while firms in FTZs were employing about 104,000. During this period (starting with the economic reforms in 1987), the country adopted a new industrial strategy in which the successful FTZs were to serve as poles of growth. The FTZs were to be increasingly integrated into the rest of the economy, which was to supply more of their inputs from new foreign-owned firms and joint ventures. The central aims were to promote foreign investment and develop internationally competitive local industries. Manufactured exports, including those from FTZs, achieved astonishing growth within the new policy reforms; FTZs exports increased from 14% of the country's exports in 1982 to 24% in 1990 (The World Bank, 1992). In this context, the incentives available to the FTZs and LMWs firms are best seen within Malaysia's overall system of export promotion. More than any other Asian developing country establishing FTZs, Malaysia has succeeded in attracting large amounts of foreign investment into its zones, particularly in the field of electronics. To a large extent, this was due

to the favourable incentives offered to investment in these zones. The official package available to FTZs firms has four main components: (a) duty-free imports of raw materials and capital equipment; (b) streamlined customs formalities; (c) subsidised infrastructure facilities; and (d) company income tax incentives. Except for the subsidised infrastructure facilities, many features of the overall incentive package available to LMWs firms are similar to those available for the FTZs (for details on the provisions of these packages see Warr, P.G. 1987b, pp.33-35).

4. Turkey

With the introduction of new economic policies in the early 1980s, Turkey had three objectives: more liberalisation, more security especially for foreign investors, and less bureaucracy. With the objective of increasing export-oriented investment and production in Turkey, accelerating the entry of foreign capital and technology, and increasing the utilisation of external finance and trade possibilities, the Free Zones Law was put into effect in 1985. Since then, Mersin and Antalya Free Zones became operational in 1988, Ege and Istanbul Ataturk Airport Free Zones in 1990, Trabzon Free Zone in 1992, and Istanbul Leather Free Zone in 1995. Commercial activities have been performed in Mardin and Erzurum-Eastern Anatolian Free Zones since October 1995 and the new implementation, Istanbul International Stock Exchange Free Zone began to perform its activities on February 1997. Lastly, commercial activities started in Rize Free Zone in March 1998. In addition, there are five zones whose location and boundaries have been determined by the decree of the Council of Ministers (numbered 95/6571) and which are planned to operate in 1999. These are Izmir Menemen Leather Free Zone, Samsun Free Zone, Adana Free Zone, Istanbul Thrace Free Zone, and Kayseri Free Zone.

The geographical location of Turkey provides significant advantages to the Turkish FTZs that are adjacent to the major Turkish ports on the Mediterranean, Aegean and Black Seas, and so, they have easy access to international airports and highways. In general, all kinds of activities can be performed in Turkish FTZs: manufacturing, storing, packing, general trading, banking and insurance, etc. Investors are free to construct their own premises, but the zones also have available office spaces, workshops, or warehouses offered for rent on attractive terms. All fields of activities open to the Turkish private sector in the zones are also open to foreign or to joint venture companies. The incentives offered in the Turkish FTZs include:

- Income generated through activities in the zones is exempted from all kinds of taxes, and can be freely transferred to any country.

- The validity period of operation licence is 10 years maximum for tenant users, and 20 years for users who own their premises in the zone; the period can be prolonged to 99 years.
- There is no limitation on the proportion of foreign capital participation in investment within the zones.
- Sales in the domestic market are allowed.
- The infrastructures are compatible with international standards.
- Red tape and bureaucracy have been minimised during application and operation phases by authorising only one agency in charge of these procedures.
- There is no restrictions regarding prices, standards or the quality of goods in the zones.
- And all the articles of the domestic laws contrary to the provisions of the FTZs Law are not applicable, and any disputes are resolved by the Supreme Arbitration Council.

By the end of 1997, there were 1684 firms engaged in commercial operations in the Turkish FTZs, 1395 domestic firms and 289 foreign. They offered employment opportunities for 8750 persons. In 1997, $5.5 billion of trade volume was realised in FTZs in Turkey, showing an increase of 52% as compared to the previous year. This figure constitutes 7.6% of the Turkey's trade volume, which was actually $72 billion in 1997. In the same year, the breakdown of the trade volume by sectors was 78% industrial goods, 21% agriculture, and 1 per cent mining and quarrying. 22% of the trade volume generated in the FTZs was with the European Union, 8% with other industrial countries, 7% with the Commonwealth of Independent States (CIS), 49% with Turkey and 14% with developing countries. The targeted volume of trade for the Turkish FTZs in 1998 was $8 billion. This figure represents 10% of the anticipated $80 billion of trade volume of Turkey for 1998. The remaining 90% will be derived from the additional trade volume to be created by the newly activated FTZs. Targets in 1998 include also specialisation in the FTZs regarding the sectors which have potential to have a bigger share in world trade in the future. For example, considering the major function of an FTZ in the acquisition of advanced technology and creation of techno-parks, the Aegean Free Zone has been designed as a Technology Transfer Centre. It provides modern infrastructure facilities and attractive incentives for research and development (General Directorate of Turkish Free Zones, Monthly Report, December 1997 and January 1998).

5. United Arab Emirates

The Jabel Ali Free Zone (JAFZ) in the United Arab Emirates provides an interesting and, to some extent, a unique example of FTZs development in OIC

member countries in the Arabian Gulf and the Middle East regions. The JAFZ is located in the Emirate of Dubai, on a coastal site on the Arabian Gulf. It has its own deep water and modern shipping facilities, as well as readily available industrial buildings, warehouse space, and necessary utilities. Established in 1985, the JAFZ steadily built up its area over 100 sq km, where in 1994 over 600 international companies were operating in a variety of light industrial and trading activities. Currently, more than 1300 companies from more than 80 countries are operating in the Zone. Although the Emirate of Dubai as a whole possesses free zone characteristics (e.g., tariffs below the GCC minimum of 4%, imports not controlled, and no taxes on profits or personal income), the JAFZ goes an important step further as only in this zone does the government permit 100% foreign ownership and authorise a single agency (The JAFZ Authority) to process and facilitate all licences, permits, promotion, and other procedures necessary for investors to do business there. These benefits, which effectively bring together the status of extraterritoriality on the JAFZ, along with the convenience of available buildings, a port and other efficient and dynamic infrastructure, are the main reason why it has attracted a substantial portion of the country's new commercial and industrial investment. In summary, these elements and others such as a 100% transfer of capital and profit, absence of currency restrictions, absence of corporate tax for 15 years renewable for an additional period, and proximity to GCC countries and Indian sub-continent, define the JAFZ in terms of its distinctive features in the region.

The JAFZ is not, however, without its critics. The large number of distribution centres of foreign-based manufacturers deprives local traders of business and decreases the benefits afforded to the local economy. For instance, the zone firms employ a large number of foreign workers and are seen by some as purposefully avoiding local sponsors and/or partners. Furthermore, the zone activities are more commercial than industrial, which limits the local value added component of re-exported goods. Concern may also be raised by the exclusive manner in which the JAFZ permits a more liberalised foreign investment climate than in the remainder of the country, putting other areas at a relative disadvantage. Nevertheless, the JAFZ continues to attract investment and grow (eg The JAFZ Authority is receiving some 100 applications for investment each month). Currently, The JAFZ Authority shows a preference for those investments that are less energy intensive, but with higher requirements for port facilities and shipping. As a result, trade companies and light industries will continue to predominate in the zone (Jabel Ali Free Zone Authority, 1998).

In general, the majority of FTZs in OIC countries have developed two main characteristics different from those in many other regions: (a) most FTZs are not industrial or processing zones, but rather zones which have a mix of

different types of activities, the bulk of which are oriented towards trading activities. In some other countries, they are engaged in a massive port complex activities such as warehousing or oil supply rather than being new bold initiatives in policy terms and far from the original FTZ intention; and (b) unlike EPZs, there is generally no specific requirement that all or most of the goods produced in the zones are to be exported, and there are open eligibility criteria which do not specify value added, transformation, manufacturing, or some other characteristics which many countries have used to limit the incentives in free zones to manufacturing or value added services firms. Although these characteristics vary among FTZs in different OIC countries, they are present to a certain degree in almost all of them. The exception here may be with FTZs in a few countries like Malaysia and, to a lesser extent, Turkey and United Arab Emirates.

Indeed, FTZs programmes in OIC member countries should be pointed out as one of the most successful candidates of trade and industrialisation promotion modalities. The main reasons for this include: (1) the position of the OIC region in world geography with proximity of many member countries to major international markets and industrialisation blocs, and their location in places on or close to international trade routes junctions; (2) the complementarity potentials available to OIC countries collectively based on different levels of their natural, financial, human and technical resources; (3) the fact that some OIC member countries have achieved relatively significant levels of industrialisation and technological development; (4) the recently adopted strategies and policies for promoting and encouraging FDI flows in many member countries; and (5) the relatively inexpensive supply of labour in almost all OIC member countries.

6- CONCLUDING REMARKS

Free zones in general are areas which, while existing within the political borders of a country, are nevertheless beyond its Customs line, and in which certain economic activities receive rather more facilities and encouragement than they do in other parts of the country. On the basis of the purpose of their foundation and, thus, also of the functions they perform, free zones may be divided into two broad groups: ***free trade zones***, and ***free production zones*** (the idea of this classification is drawn from the information in Appendix-2). The first group, ie ***free trade zones,*** often takes forms like: free ports, commercial free zones, duty-free zones, customs free zones, and tax free trade zones. Generally, in such zones, permission is not granted for industrial activities. However, such trade and commercial activities are carried out as storage of goods, packaging and preparation for market, shipment, re-export, and transit trade. By contrast, the second group, ***free production zones***, are

relatively more recent innovations. They often take forms like: export processing zones, special economic zones, industrial free zones, investment promotion zones, joint enterprise zones, and technology zones. Like free trade zones, they are extra-territorial, but different in that they are explicitly designed to facilitate the processing, manufacture, and assembly of goods and services destined primarily for export markets. International capital generally invests in these zones in order to make use of such advantages as benefiting from inexpensive labour and raw materials and from exemptions from various types of taxation.

As a general rule, FTZs programmes can be used in a country where suitable conditions for export-oriented industry cannot be created on a countrywide basis because of infrastructural deficiencies and regulatory administrative obstacles. Under certain conditions of an appropriate political and economic policy environment, FTZs programmes can represent an efficient industrialisation and export-oriented modality in the host countries. Since FTZs take the form of specially determined areas of legal and/or geographic nature in which economic activities are freed from all regulations, they could basically represent a second-best type solution for countries wanting to benefit from a greater and more efficient integration into the international markets without subjecting the entire economy to trade liberalisation and deregulation in the first stages of their movement towards more liberalised, open economies. By eliminating tariffs and most other trade restrictions in these zones, the factor intensity of production can be made to correspond more closely with factor endowment of the host country. Comparative advantages in the host countries can thus be more efficiently exploited. FTZs can be very effective at the early stages of an export drive, as means of attracting investors and demonstrating a country's export potential, especially in LDCs which cannot package the critical elements to initiate an outward-oriented developed strategy. However, development of infrastructure, formulation of appropriate incentives and other elements of the work environment must be well-managed. From this perspective, the establishment of FTZs, especially in LDCs, is further seen to produce positive welfare effects similar to those of the trade liberalisation regime.

With different geographical locations, heterogeneity in economic structures, and discrepancies in policy priorities at the national level, FTZs in the OIC countries are varied in number, type and level of success. However, in general, most FTZs in OIC countries are not industrial or processing ones, but rather zones which have a mix of different types of activities, the bulk of which are oriented to trading activities. In some other countries, they are engaged in massive port complex activities such as warehousing or oil supply rather than being new bold initiatives in policy terms and are thus far from the original

FTZ intention. Although these characteristics vary among FTZs in different OIC countries, they are present to a certain degree in almost all of them. The exception here may be with FTZs in a few countries like Malaysia, and, to a lesser extent, Turkey and the United Arab Emirates. Nonetheless, FTZs could be used as modalities to mobilise resources and technologies amongst OIC countries whereby complementarity is achieved. In other words, the unused resources of one country, due to a certain economic situation and policy environment, could be invested through joint-venture enterprises in FTZs in other neighbouring countries or used to attract other countries' funds and technologies to invest in FTZs closed to these resources for the benefit of all participants. However, since FTZs can take many forms due to the various purposes of their foundation and, thus, due to the various functions they perform, countries interested in the potential use of such programmes should carefully study and analyse the economic indicators, activities, rules and regulations in order to determine the most appropriate forms of FTZs. In fact, drawing upon the potentials available to the OIC countries collectively in terms of natural, financial, human and technical resources, and under certain conditions of keeping the inward-oriented policies at a minimum level, taking advantage of their position in world geography, economic complementarity, and radical reforming of their trade policies, regimes and administrative measures, FTZs in the OIC region could be considered among the successful ones around the world.

However, the successful FTZs of the future will be those which are well planned and managed, preferably by a private sector developer, supported by efficient regulatory agencies, and located close to international transport and communications facilities in countries which enjoy good infrastructure and a favourable business and political environment with the availability of raw materials near the zones to be processed and exported. There are, however, a number of factors, which will influence and shape the character of FTZs in the future. These include: (1) increasing global competition for FDI or foreign export-oriented investment "globalisation factors"; (2) development of regional economic blocs, and promotion of intra-regional trade "regionalisation factors"; (3) considerations relating to the transfer of technology and skills, and the development of linkages between FTZs and the domestic economy of the host country; (4) the growing importance of international services activity; (5) the trend towards and emphasis on private-sector FTZs development; and (6) the trends towards and the need for making available FTZs facilities and benefits on a country-wide basis.

Taking all this into account and assuming that the application of the UR will proceed as agreed, and considering the globalisation trend of the world economy, it seems very likely that, over time, FTZs will decline in importance.

Once countries develop effective economies-wide free trade regimes and minimally regulated market mechanisms in accordance with the UR agreements, the relative importance of FTZs will tend to decline. This will, no doubt, have a significant negative effect on the compatibility and competitiveness of FTZs in the long run in terms of diminishing the importance of their purposes of establishment and, thus, also the functions they perform and ultimately make them increasingly less meaningful for achieving the various goals for which they are commonly considered. Thus, FTZs programmes should be viewed as a temporary solution and a step towards economy-wide, duty-free trade systems. They should not be planned in isolation, but as part of a broad, long-term strategy supported by further measures for regulatory reforms and macroeconomic stability to develop an internationally competitive economy.

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Appendix- 1: Zone Terminology

Group 1- Trade	Group 2- Exports	Group 3- Processing	Group 4- Economic Activity	Group 5- General
Customs Zone	Duty Free Export Processing Zone	Export Processing Free Zone	Investment Promotion Zone	***Free Zone (FZ)***
Customs Free Zone	Export Free Zone	***Export Processing Zone (EPZ)***	Joint Enterprise Zone	***Free Port (FP)***
Free Trade Zone (FTZ)	Export Processing Free Zone	Free Export Processing Zone	Technology Zone	Maquiladora
Tax Free Trade Zone	***Export Processing Zone (EPZ)***	***Free Production Zone***	***Special Economic Zone (SEZ)***	Free Tax Zone
	Free Export Processing Zone	Industrial Processing Zone	Zone of Joint Entrepreneurship	
	Export Processing Regime (EPR)	Industrial Free Zone	International Service Zone	

Source: United Nations Centre for Transnational Corporations (UNCTC): The Challenge of Free Economic Zones in Central and Eastern Europe, 1991. Cited in "UNIDO- Export Processing Zones: Principles and Practice", (Undated, unedited publication).

Appendix- 2: Types of Free Trade Zones

Types	*Physical Characteristics*	*Economic Objectives*	*Duty Free Goods Allowed*	*Typical Activities*	*Additional Incentives*	*Domestic Sales*	*Other Features*	*Examples*
Free Port	Entire city or jurisdiction	Development of trading centre	All goods for use in trade, industry, or consumption	Trade, services, industry, banking, etc.	May be comprehensive and tax-free	Unlimited, upon payment of full duty	Additional incentives and streamlined procedures	Hong Kong, Macao, Singapore, Batam, Labuan
Commercial Free Zone	Warehouse area; often adjacent to port or airport	Facilitating of trade and imports	All goods for storage and re-export or import	Warehousing, break-bulk, packaging, distribution	None	Unlimited, upon payment of full duty		Colon, Miami, Jabel Ali
Export Processing Zone	Industrial Park	Development of export industry	Capital equipment and production inputs	Light industry and manufacturing	Profits tax and regulatory relief	Limited to small portion of production	May be extended to single-factory sites	Ireland, Taiwan, Malaysia, Dominican, Mauritius
Special Economic Zone	Entire province, region, or municipality	Deregulation; private sector investment in restricted area	Varies; similar to EPZ	All types of industry and services	Liberalisation of otherwise restrictive conditions	Highly restricted	Developed by socialist countries	China (Southern Provinces)

Source: Constructed on the basis of the information available in the sources of Appendix-2 above, and the World Bank 1992.