



TOGETHER
for a sustainable future

OCCASION

This publication has been made available to the public on the occasion of the 50th anniversary of the United Nations Industrial Development Organisation.



TOGETHER
for a sustainable future

DISCLAIMER

This document has been produced without formal United Nations editing. The designations employed and the presentation of the material in this document do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations Industrial Development Organization (UNIDO) concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries, or its economic system or degree of development. Designations such as “developed”, “industrialized” and “developing” are intended for statistical convenience and do not necessarily express a judgment about the stage reached by a particular country or area in the development process. Mention of firm names or commercial products does not constitute an endorsement by UNIDO.

FAIR USE POLICY

Any part of this publication may be quoted and referenced for educational and research purposes without additional permission from UNIDO. However, those who make use of quoting and referencing this publication are requested to follow the Fair Use Policy of giving due credit to UNIDO.

CONTACT

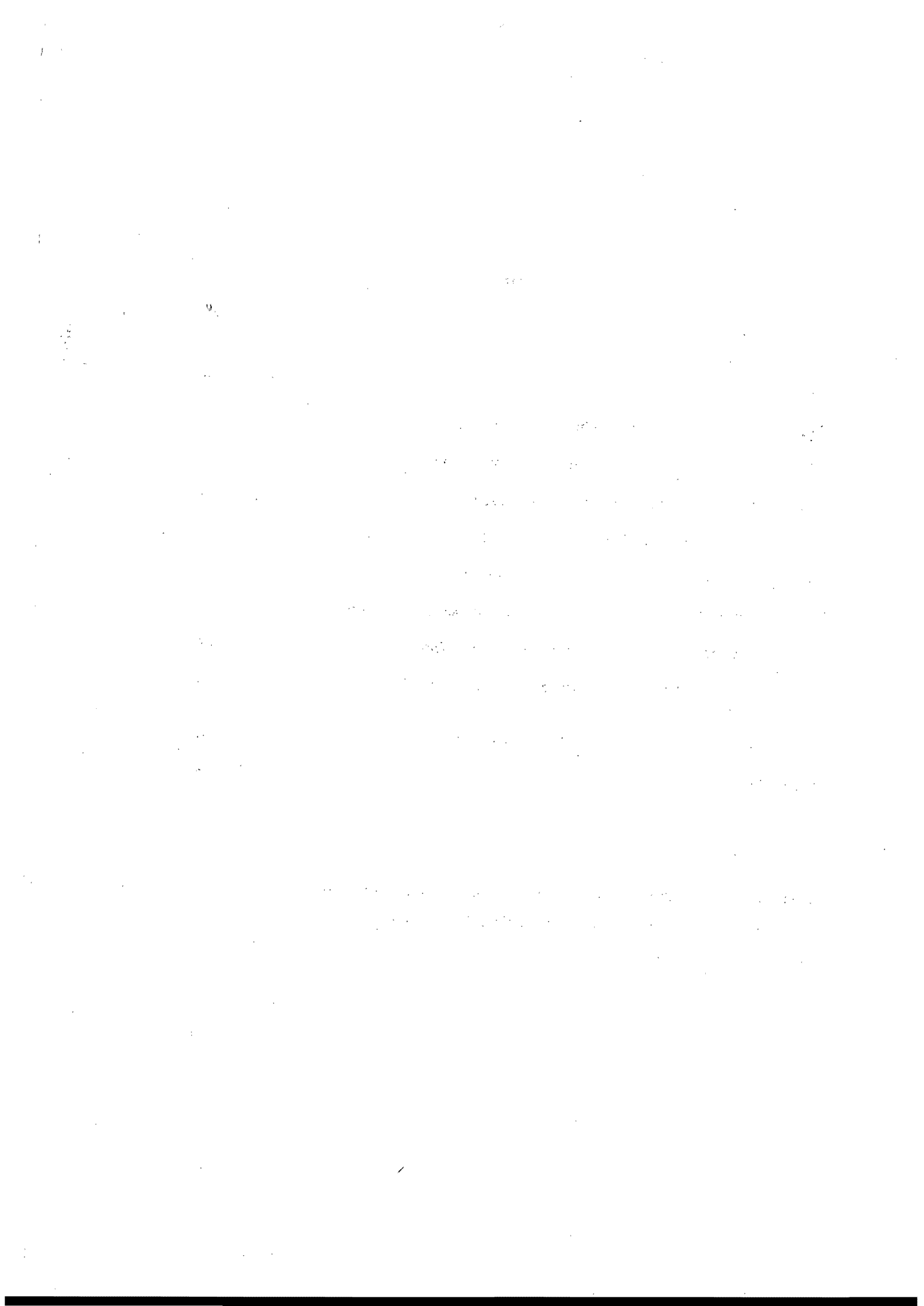
Please contact publications@unido.org for further information concerning UNIDO publications.

For more information about UNIDO, please visit us at www.unido.org

CONTENTS

	<u>Page</u>
I. Introduction	5
II. Objectives of an Industrial Free Zone	6
III. Advantages of an Industrial Free Zone	8
IV. Attraction of Foreign Investments	9
V. Export Orientation of an Industrial Free Zone	11
VI. Criteria for Selection of Industries	12
VII. Forms of Incentives in an Industrial Free Zone	15
VIII. General and Common Services in an Industrial Free Zone	17
IX. Organization and Administration of an Industrial Free Zone	18
X. Promotion of an Industrial Free Zone	20
XI. Conclusion	22

Annex: Aide Mémoire (UNIDO Technical Assistance on the Establishment of an Industrial Free Zone)



I. INTRODUCTION

The history of a free port or free zone can be traced back more than 400 years ago. Special trade concessions were given to cities or ports, trans-shipments and provisional storage of goods and commodities for re-export being predominantly the chief function. Parallel to the development of world trade, such free ports were created as extended posts of economic and trade activities for the colonial powers, far from their motherland where merchandise was originally accumulated for distribution to the colonial markets of the area. Hong Kong, Aden, Singapore are examples of this case.

In recent years, this type of free zone became very popular and in more than 50 countries in the world over 130 free zones have been created. They are called free zones, free trade zones, free ports, free perimeters, entreports etc., and their common function is to offer governments and traders the status of freedom of duty, customs and other types of restrictions otherwise imposed on the goods and commodities moving in and out of the country - or as it is referred to - the customs territory. In other words, the free zones are considered as ex-customs-territory.

Although the rules and regulations may differ from case to case, these free zones usually allow the cargo to be stored, processed, assembled, manipulated, and transported without interference of the customs authority, insofar as the goods do not cross the border line which encloses the free zone from the customs territory. This type of free zone is usually classified as commercial free zones or free trade zones. Colon-Panama and Beirut, as well as most of the free ports and free zones in Europe and USA represent this category.

During the last 10 - 15 years, a new concept of free zones emerged. Contrary to the traditional type of commercial free zone, the new type of free zone is referred to as an industrial free zone, free manufacturing zone or export processing zone. Whereas the commercial free zones are chiefly functioning as warehousing, distributing and re-exporting depots, the main thrust of activities of the industrial free zones are directed towards industrial manufacturing activities.

Entrepreneurs are invited to carry out manufacturing activities within the fenced-in area of the free zone. Here, customs freedom is offered on imported production means and equipment, raw materials and components. Also, preferential treatment is given on capital and income taxes, repatriation of profits, cost of utilities, etc. In many cases, various other kinds of fiscal and physical incentives are additionally provided to attract entrepreneurs to establish themselves in the industrial free zone. Very few examples of this type of industrial free zone exist as yet, among which those established in Kaohsiung (Republic of China), Shannon (Ireland) and Kandla (India) may be mentioned as representatives of the group.

According to recent investigations of UNIDO, more and more countries, especially the developing countries, are interested in creating an industrial free zone. The existence of such plans have been announced by more than 30 developing countries, many of them also expressing their desire to obtain technical assistance services of UNIDO.

II. OBJECTIVES OF AN INDUSTRIAL FREE ZONE

An IFZ generally permits to import production means and equipments, raw material requirements and components free of duty and without customs control, provided that these goods as well as the semi-manufactured or finished products therefrom do not cross the border limit of the free zone into the customs territory. This action of

waivering the otherwise collectable customs revenues and various tax revenues by the government is done in consideration of the fact that the host country may secure merits and advantages in other visible and invisible forms, through the Industrial Free Zone.

The creation of an Industrial Free Zone is commonly considered by a combination of several reasons, such as:

- (a) a part of an overall industrial development programme of the country or of a certain region of the country;
- (b) a measure for solving the employment problem by the creation of new labour opportunities;
- (c) stimulation of development of export-oriented industries, to increase export volume and foreign exchange receipts;
- (d) acquirement of modern industrial techniques from abroad through which the level-up of the domestic industrial standard may be achieved;
- (e) encouragement of new industrial investments from domestic, as well as foreign capital markets;
- (f) means of a concentrated and rational development of infrastructure with the industrial free zone acting as an industrial pole.

The geographical position of the country and its access to the sources of supply of raw material components or to the markets of the finished products, plays an important role, particularly as it would effect the efficiency and successful operation of the Industrial Free Zone. Therefore it is of paramount importance that the plans of establishing an Industrial Free Zone be decided only after a carefully implemented study on the feasibility of the project. Such a study should consider the various objectives of the planned free zone, and make a cost-benefit analysis from the national economic point of view.

III. ADVANTAGES OF AN INDUSTRIAL FREE ZONE

1. Advantages to the host country:

- (a) creation of new job opportunities;
- (b) development of export-oriented industries;
- (c) increase of export and foreign exchange receipts;
- (d) stimulation of domestic and particularly foreign investments;
- (e) general level up of industrial techniques;
- (f) concentrated and rational work on the infrastructure development;
- (g) creation of new sources of income through subcontracting as well as sales of utilities and other inputs;

2. Advantages for the Entrepreneurs:

Apart from the above advantages to the host country, it must not be forgotten that an Industrial Free Zone should bring attractive merits to the entrepreneurs, namely the "inhabitants" of the free zone, since an Industrial Free Zone cannot exist by a one-party game of the host country. These merits can be enumerated as follows:

- (a) Duty free status of production means and material components;
- (b) Capital and income tax holidays or concessions;
- (c) Special depreciation and profit repatriation allowances;
- (d) Investment finance facilities made available to investors;
- (e) Availability of standardized factory buildings on lease or sales basis;
- (f) General and common service facilities;
- (g) Preferential rates and tariffs for rent of land, utilities, services and transportation;
- (h) Training facilities for potential workers;
- (i) Simplified procedures of obtaining by the investors the various licences and permits required in connexion with the setting up of new industrial activities, through the centralized autonomous free zone administration, etc.

Insufficient industrial atmosphere is also a serious problem which the developing countries have to face during their industrialization process of the country. An industrial free zone is believed to be one solution to cope with the problem. Within a comparatively short period and reasonably lower spendings by the Government, concentrated efforts can be directed towards the preparation of infrastructure and other aspects considered necessary and important, within the industrial free zone, and its immediate neighbouring area.

IV. ATTRACTION OF FOREIGN INVESTMENTS

As described above, an Industrial Free Zone can provide a number of advantages to the "inhabitants" of the zone. How, then, can investments of the entrepreneurs be attracted to the zone to win over the inhabitants? In order to clarify this, the motivation of the entrepreneurs must be analysed.

Foreign manufacturers with world markets, particularly being pressed by the increasing level of labour cost on the one hand and the sharpening of international and national competition on the other, are constantly seeking ways and means to cut down or minimize their manufacturing and distribution costs. Rationalization of the production technique and transportation methods, for instance by containerization, the modernization of sales and distribution network are some examples of such efforts. An Industrial Free Zone could well provide additional means of rationalizing their production and sales costs. Should they advance their base of manufacturing to a suitable Industrial Free Zone, some of the following reasons could bring decisive merits in this direction.

- (a) Cutdown of raw material transportation costs;
- (b) Cutdown of finished products transportation costs;
- (c) Cutdown of labour costs;
- (d) Availability of abundant qualified labour power;
- (e) Reduction of initial investment cost and consequently lower percentage of so-called sleeping capital, through the available fiscal and physical incentives, common and general services and other preferential treatments provided in the zone etc.

By attracting foreign entrepreneurs, the host country could also well benefit from the investments. In addition to the advantages mentioned before, the following merits may be envisaged:

- (a) In many cases, such foreign investors do not bring a whole team of their own staffs for the management of their enterprise. Quite often, important management posts are filled in by locally recruited staffs. This provides the chance of training local people for high official posts, the knowledge and experience of which will benefit the general level-up of managerial staffs in the country, and the fact of which can later on be utilized for similar tasks in the domestic industries.
- (b) Investors of developed countries are often inclined to expand their production activities in foreign countries through such forms of co-operation as subcontracting, joint ventures or simple technical co-operation by licensing their know-how techniques. Such industrial co-operation can only bring favourable results to the developing countries since it will create possibilities of acquiring new industrial production and management techniques, which is lacking or insufficiently available and also accelerate the improvement of the industrial atmosphere of the country.
- (c) The establishment of new industries would stimulate the development of various ancilliary industries in the host country. For instance, the supply of raw material components, packaging material and services and other types of activities by the existing domestic industries to the inhabitant industries in the Industrial Free Zone could bring a favourable impulse of improvement and level up of their technique towards international standards. This would definitely benefit the acceleration of an overall industrial development of the country. For this purpose however, the forward/backward linkage between the domestic industries and those in the free zone should be encouraged and the isolation of the industrial free zone be avoided.

- (d) The foreign entrepreneurs usually bring the export markets as well as the techniques, experience and knowledge of the markets with them. This fact would save the host country from going through the painful exercise of preparing deep market surveys and investigations during the preplanning stage before the decision of creating an industrial free zone. It is often witnessed that the staggering of the export trade in developing countries is caused by lack of proper knowledge and technique on export production as well as export marketing.

V. EXPORT ORIENTATION OF AN INDUSTRIAL FREE ZONE

Among the various reasons for a developing country to establish an Industrial Free Zone, one of the most important is felt to be the promotion of development of export oriented industries. In many cases, the developing countries have home markets which do not provide a size of demand large enough to justify the operation of an economic-scale production. Either the factories have to operate with a considerable degree of excess capacity, or the scale of production is too small, resulting into a high cost of production, and making the products uncompetitive in the foreign market.

On the other hand, as the industrialization process of the developing countries is usually still in its lower stage of progress, the domestic availability of component materials for industrial production is limited. A considerable percentage is dependent on imports.

These conditions clearly indicate the advantages which an Industrial Free Zone may bring, if the Industrial Free Zone is expressively oriented towards export production. The limited size of the home market can be favourably complemented by the availability of export markets, thus enabling an economic-size operation of production. The higher percentage of imported component material may benefit from the duty and tax free status offered in the zones.

As observed elsewhere, the direct relationship with, and supply to foreign markets with international level requirements of quality, packaging, presentation etc., will also effect favourably the production method and technique of the industry, and can start a kind of chain reaction for a higher levelled industrialization of the country, through its spilt-over effect.

The demands existing in the home market may also be satisfied through the supply of products manufactured in the Industrial Free Zone. In this case, the goods thus supplied should be levied with normal import tariff rates of the commodities, as if it were imported from foreign countries. Nevertheless, it may also be worth consideration to provide a slightly advantageous tariff rate to such free zone products, as it would then become an additional type of incentive to promote establishment of industries in the Industrial Free Zone.

The percentage of such supply to the domestic market should not be too large, say up to 20 - 30 %, so that at least 70 - 80 % of the products be destined for third country markets. This is particularly important, since otherwise, as we can see from the characteristics of the commercial free zone, it may soon turn out to be that the Industrial Free Zone becomes overwhelmingly import-oriented, and decrease the merits of its contribution to the national economy, as compared with the sacrifice of the country caused by the provision of duty and tax holidays and other incentives and concessions.

VI. CRITERIA FOR SELECTION OF INDUSTRIES

The objectives for creating the Industrial Free Zone formulates the basic guideline for the selection of admissable industries to the Industrial Free Zone. A reasonable approach to cope with this problem is to set up a criteria of industries by fixing certain basic groupings. Such groupings will be made according to the desirability of the industry towards achieving the set of objectives of the Industrial Free Zone, or its importance in the general industrialization plans of the country.

The most desirable type of industries would come under "A" category, followed by "B" and "C" categories according to their degree of contribution or significance. Special preferential incentives could be provided to the "A" group, and standard incentives to the "C" group, "B" group receiving arrangements lying between the scope of incentives of "A" and "C".

It is important to note that despite such criteria of groupings, the decision of the desirability or suitability of certain types of industries should be closely related to a number of problems which are characteristic to each country. Namely, the economic conditions, the development policies of plans and other aspects of the host country have to be carefully scrutinized and only after such analysis is satisfactorily completed should the criteria be set up. The priority groupings should also be kept flexible so that changes can be made according to the development of situation at a later date.

The types of industries to be classified as "A" category may be any of the following basic concepts, although the list is not exhaustive, and ordered at random:

- (a) Labour intensive industries;
- (b) Export-oriented industries;
- (c) Industries which have a sound basis of viability as to its future prospects of development;
- (d) Industries based on a reasonably sound supply position of raw material from the domestic market, and from foreign markets within a reasonable transportation distance;
- (e) Higher added-value types of industries;
- (f) Industries based on modern and efficient production technique;
- (g) Industries which raw materials or finished products do not have any decisive disadvantage caused by the site location of the Industrial Free Zone;
- (h) Industries which do not contradict with the present availability of future development prospects of the utilities supply, development of infrastructure, etc.;

- (i) Industries which have greater possibilities of the forward/backward linkage with existing domestic industries or traditional industries of the country, in other words, such industries which could use part of the raw material on components as part of their production inputs, etc.

A free zone will lose to a certain extent its significance in case the raw material or components are not imported but are based on supplies from the domestic market (customs area). In other words, an industrial free zone will prove most effective in cutting down or totally abolishing import duties and taxations of the raw materials and components, as well as the minimizing of time and energy consuming duty and tax procedures of work, usually spread over a number of government and public offices. The selection of industries should be made with this point in mind.

The operation of an industrial free zone is largely effected by the development of infrastructure in the regional vicinity of the free zone. Therefore, the selection of industries admissible in the free zone should be made so that it fits the plans of development of the free zone, which in its turn should be coordinated with the development of infrastructure and particularly that of the utilities as well as the commune services for the workers.

It is extremely important to fix a strict limit of a modern technology to be adapted by the industries, be it labour intensive or capital intensive types. This is necessary from the viewpoint that the products should be of world-international level as to its qualities, in order to maintain their international competitiveness.

In case the main objective of the industrial free zone is to solve the unemployment problem through the creation of new labour posts, labour intensive industries would be classified under the "A" category. However, care should be taken by host countries with a limited availability of labour force. The stimulation of the development of such industries where the labour intensiveness is less, should be considered, in order to avoid excessive pressure of increasing demand of labour. This could probably be achieved through the phasing of the free zone development plan, where phase 1 would lay stress on labour intensive industries and phase 2 emphasizing the development of less labour intensive

Also, attention should be paid to promote such types of industries with higher added value, and also where the weight of composition of the labour force still will be shifting over from the less-skilled towards the medium and high-skilled workers. A criteria of industries which could assure a well proportioned balance of the labour force in terms of sex, age and skill is also an important factor to be observed.

The criteria of admissible industries as fixed for the KEPZ is felt to be a fair example of how the selection of industries should be made in order to satisfy the objectives of the industrial free zone most effectively.

VII. FORMS OF INCENTIVES IN AN INDUSTRIAL FREE ZONE

When discussing about the forms of incentives of an industrial free zone, it must be noted that the incentives meant are for the purpose of attracting and inducing new industrial investments by the domestic and foreign entrepreneurs, and not the so-called export incentives or export bonus system which objectives are to promote the export trade activities.

Most countries, whether developing or developed, have a range of investment promotion incentives or so-called fiscal incentives made available to promote new industrial investments. In the case of developing countries, it has been recognized that quite often such fiscal incentives are not entirely fulfilling their objectives of attracting foreign investors.

The reason can be traced back to the fact that the incentives are often offered under too complicated and inefficient conditions that they cease to be "incentives" any more. Although attracted at first, the investors are not induced to make any commitments after they discover the unstreamlined application procedures, and the bureaucratic handlings, and foresee the demerits of the set-up.

Successfully operating free zones provide an ideal example of having a centralized and autonomous Administration Office, located within the zone, and authorized by the Government to undertake all duties and responsibilities of managing and operating the zone. The "red tapes" thus reduced to the minimum could work as a most effective incentive and inducement for entrepreneurs interested in new industrial investments in the country.

An industrial free zone usually provides in addition to the fiscal incentives, a range of physical incentives which if well coordinated and complementary to each other, could stimulate strong interests among the potential

investors. Although not exhaustive, the following are some of such promotional fiscal and physical incentives of an industrial free zone.

- Full exemption of duties and taxes, for a certain given period, on all machineries and production equipments as well as on the raw materials and components required for production activities in the zone. The period of duty/tax holidays should be given most careful consideration, based upon the cost/benefit analysis of the project in connexion with the national economy. The fiscal incentives should be decided in the light that it would be sufficient to attract and induce foreign investments to be made in the zone. The balancing of the costs and benefits, or in other words, the sacrifice given by the host country should be well balanced against the foreseen direct and indirect benefits deriving from the industrial free zone project.
- Income tax exemption of 5 to 10 years, again the period being as above a matter of careful consideration, on the capital investments of domestic and foreign origins.
- A special period of holiday or reduction of rates on other direct and indirect taxes, surtaxes, surcharges etc. payable by enterprises if not located in the free zone.
- Freedom of foreign exchange control with a guarantee of the same status in the future, and with the assurance of free repatriation of earned profits up to a certain fixed annual rate or percentage.
- Preferential financing facilities, such as the provision of short, medium and long term loans with advantageous rates of interest, provided they are required for the establishment of the industries in the zone, including the construction of non-standard factory buildings.
- Preferential tariff rates on transportation costs between the zone and the sea-or-air-ports of arrival or departure in the country, as well as on the cost of utilities, rents of ground and buildings (standard factory buildings), common and general services charges, etc.
- Possibilities of renting or purchasing pre-constructed standard factories and office buildings or spaces, according to the wishes of the industries. This could relieve the investors from spending their investment capital on long term.

fixed assets, or in other words, minimize their amount of sleeping capital.

- The availability of work and repairshops, canteens, medical services or clinics, banking services, post and telecommunication services, petrol stations, petrol and security services, public warehouses, transportation and forwarding agent services, cooperative insurance services, recreation facilities etc. all established in the zone for the benefit of the inhabitants and their workers, would amount to a considerable portion of reducing the work as well as the initial investment costs of the investors had these had to be made available by themselves, and brings a kind of physical incentive to the investors.

The industrial free zone, supported by the fiscal and physical incentives would thus be able to offer to the investors the conditions desirable, and could not only attract but induce them to establish themselves in the zone. If the industrial free zone is designated as an industrial development pole, supported by proper measures of the Government, policy-wise, legislative-wise and budget-wise, it could act as the stimulator for the overall industrial development of the region in the country.

It must be specifically repeated once again that fiscal incentives themselves will not be sufficient for attracting new industrial investments. A comprehensive scheme of various types of incentives should be worked out and made applicable, in order to obtain the maximum effective attraction possible. Many free zones created in the world, equipped with extensive fiscal incentives, are failing to satisfy their original plan of industrial investments, particularly from foreign sources. The missing of an overall and comprehensive incentive system is often found as the reason for such failures.

VIII. GENERAL AND COMMON SERVICES IN AN INDUSTRIAL FREE ZONE

As we have just seen, the provision of various kinds of general and common services for the free zone inhabitants could work as a useful type of physical incentive for attracting new investments.

The scope and scale of such services, however, ought to be examined and planned carefully in order that it will suit to the actual demands and requirements of the zone, or otherwise, it may in itself cause inefficient economy in the sense of excess and/or unnecessary facilities. The matter should be considered in relation to the criteria of admissible industries and the type of industries actually established in the zone. A physical development of the available facilities could be coordinated with the expansion of the free zone activities.

The income deriving from the services should be so fixed to cover the self sustaining costs of operation where possible, but should remain within a reasonable limit of preferential nature, so that they function as incentives to the inhabitants.

IX. ORGANIZATION AND ADMINISTRATION OF AN INDUSTRIAL FREE ZONE

An Industrial Free Zone Administration acting as the highest administrative authority in the zone should be established with a centralized and autonomous power, responsible to and under the jurisdiction of the Ministry in charge of industries. Its function would be to handle all matters concerned with the administration and operation of the zone, such as:

- Administrative regulations of the free zone processing and manufacturing operations;
- Planning, construction and management of all necessary installations and facilities in the free zone;
- Management and collection of fees and revenues deriving from properties owned by the zone and from public and general services;
- Factory and business registration and construction approval as well as the issuance of any permits related thereto;
- Inspection and control of plant installations, general and public services facilities, and working conditions of the labourers and workers in the zone;

- Inspection of products and issuance of related certificates or licenses;
- Control and endorsement of the import and export of commodities entering or leaving the zone;
- Measures of security and prevention of smuggling, including the patrol and inspection for such purposes;
- Rendering all other kinds of services to the industries located in the zone.

To insure an effective operation of the Industrial Free Zone Administration, branch offices of various supporting agencies should be located within the Administration office. These would include such organization as:

- Customs House
- Tax Bureau
- Post and Telecommunication Office
- Banks
- Employment Service Office
- Office for Public utilities such as power, water, etc.

These supporting agencies would assist the Administration in carrying out such duties as:

Customs inspection of import and export commodities, and supervision of all movements of commodities into and from the zone

- Assessment and collection of taxes;
- Postal and telegraphic services;
- Banking services including the extension of credit facilities to industries established in the zone;
- Providing of employment services to secure and comply with the labour demands of the industries established in the zone;
- Control and maintainance of public utilities, etc.

It should be stressed that this type of centralized and autonomous administrative organization could provide the best services to the entrepreneurs in the free zone by minimizing the bureaucratic red tape procedures, and function as an effective incentive in attracting new industrial investments into the zone.

We have heard of a few cases where the administrative set up of the free zone is not centrally organized, thus resulting into serious discouragements of further expansion of the free zone activities. On the other hand, the situation in KICPZ can be considered as a model case of such organization.

X. PROMOTION OF AN INDUSTRIAL FREE ZONE

The act of establishing an industrial free zone, as we have seen now, will have to be supported by a comprehensive range of fiscal and physical incentives, however, it should be effectively supplemented by various promotional activities to attract and promote the establishment of industries of domestic and foreign entrepreneurship. In addition to the identification and selection of industries within the criteria as set up by the Government, feasibility studies implemented by a responsible institution in the country, or entrusted abroad, could be a useful means of promoting investments by prospective entrepreneurs into the zone.

Any form of propaganda such as publications, pamphlets, leaflets, meetings, conferences, direct mail approach, should contain information on the characteristics of the zone such as the geographic location and position, proximity to transportation means, technical, economical, fiscal and physical incentives and advantages available, existing and projected infrastructure, resources and cost of power, water and other utilities, skilled and semi-skilled labour availability and cost, available training facilities, etc. as well as descriptive information on the general economic, industrial and commercial environments of the country, the region of the free zone, and the city in

which the free zone is located.

All these factors should be made on a realistic basis, if necessary with development prospects of the future, so as to avoid any illusions or misunderstandings. Special care must also be taken not to make any promises that cannot be fulfilled.

Special reference should be made to the various investment promotion facilities existing in the country, where the potential entrepreneurs may establish contacts directly for consultation and evaluation of their investment plans. Should the conditions offered at the free zone not be in line with his investment plans, the institution could provide the investor with information on other possibilities existing in the country, and which could satisfy his wishes, thus avoiding the loss of prospective investors interested in industrial investments in the country.

XI. CONCLUSION

As we have just seen, an industrial free zone could be an effective incentive to promote the development of export-oriented industries, provided that certain pre-conditions are fulfilled. We have gone through a number of such pre-conditions now. Still some problems have been left out of this lecture. For instance, the selection of site is an important problem to be given due attention and consideration. There are some opinions that an industrial free zone should be located alongside an internationally frequented seaport, in order to assure the minimizing of transportation costs. Others have the opinion that this is not always necessary since there would also be the need of transportation of the discharged goods from the sea-going vessel to the factory premises and vice-versa, and the distance of one kilometer or 15 kilometers would make only a slight difference. A number of other problems will have to be analyzed and studied carefully before letting the final decision of the site location fall.

The labour force and its suppliability should also be paid serious attention. The level of skill of the available labour force could cause dissatisfaction of the entrepreneurs. A close collaboration between the free zone authorities and the national training facilities such as vocational training schools, etc. would be most desirable. In parallel to the levelling-up of the skill of the labour force in general, suitable types of industries requiring such higher level skill would have to be promoted so that this type of workers could find proper opportunities of employment. This would simultaneously benefit the improvement of added-value on the one hand, and stimulate the general industrialization of the country on the other hand.

The problem of development of a community large enough to support the work force of the free zone is a matter which involves not only the planning of the government authorities directly connected with the establishment of the free zone, but other governmental,

districtal or municipal authorities as well. It is therefore necessary to have a kind of Free Zone Organizing Committee created which would include delegates from all possible offices which might have some relation to the act of establishment of the free zone. Supported by Government Decrees and Laws, and operated by a steering committee, it would be the responsibility of this Organizing Committee to give approval to the various aspects of the planning procedures, and make recommendations to the Government for having the plans officially endorsed and the legislative steps taken, if required.

In this respect, it must be emphasized that a well harmonized and closely cooperating relationship between and among the Government authorities, the Free Zone Organizing Committee, the public and private sectors of the country should be maintained. Later on, once the free zone is established, this mutually supporting and cooperating fine team work should be realized and maintained between the Government, the free zone administration and the private industries established in the zone.

We have in the Kaohsiung Export Processing Zone, a wonderful example of such cooperation. The joint efforts of all concerned have brought such a success in the KEPZ, that the originally fixed targets have been realized within a period of 2.5 - 3 years since its establishment.

One more subject which has to be considered is the role of an industrial free zone. In other words, what role does an industrial free zone have to play in the industrialization process of a developing country? Should it be the final aim to try to organize and operate an industrial free zone successfully? Or is it only one of the various means and measures which the developing countries could grab during the course of their industrialization process?

We have already seen that in most of the developed countries throughout the world, industrial free zones seldom exist. The free zones that are established in those countries are not meant as industrial free zones or export processing zones, but as free trade zones or commercial free zones. The functions given to them are either to store goods under a duty-free status for later import into the domestic market, or the so-called entrepot activities of temporary storage of goods for reexport to third countries. In these countries, the level of industrialization has already reached the extent that no more promotional measures are required to stimulate the establishment of new industries be it domestic or export-oriented.

From this fact, it may be deduced that an industrial free zone or an export-processing zone is useful only up to the point that otherwise without the promotional incentives provided in the free zones, very few new industrial investments can be attracted or invited. Once the industrialization of the country has achieved this optimum point, new investments would follow with or without any specific promotional incentives as is provided in a free zone. In other words, the normal fiscal incentives provided for new industrial investments suffice to induce new entrepreneurships.

It is therefore felt that the establishment of an industrial free zone should be considered as a useful means of accelerating the industrial development of the country, and not as a final aim.

The industrial free zones existing today, will be accomplishing their roles within the next years, making it unnecessary for them to exist any longer. But there will be new industrial free zones established elsewhere in the world, which would carry the duties of promoting the industrialization of another country, bringing benefits for the host country and for the entrepreneurs planning to make new industrial investments.

ANNEX

AIDE MEMOIRE

FREE PORTS/FREE ZONES AS INCENTIVES FOR
THE PROMOTION OF EXPORT ORIENTED INDUSTRIES

Background

As described in the UNIDO Programme of Work for 1971 (ID/B/64/Add.14, covering the programme of activities of Group 14, Export Industries Section) which was approved at the Fourth Session of the Industrial Development Board in Vienna, one of the supporting activities of Headquarters is the above subject under reference number 14.02.03.

Through the study and analysis of means and measures for the promotion of industries oriented towards export production among the developing countries, UNIDO has come to the conclusion that the establishment of free zones could bring attractive results in the promotion of the development of export oriented industries, provided they are properly organized and managed.

In most cases, the promotion of export oriented industries and their activities is of crucial importance to the economy of the developing countries, in view of: -(1) the relatively small size of the home market hindering the operation of industrial production on an economic scale, (2) the need for foreign exchange earnings for the further industrialization of the nation, and (3) the need of providing employment to considerable sections of the population through such industrialization. The attraction of foreign investment for establishing industries for export production, through incentives created by the establishment of free zones under proper management, can be considered as a meaningful measure. It will bring new technologies into the country, on the one hand, and will stimulate the development of ancillary industries operating in the country but outside the border limits of the free zone, through technical co-operation between the domestic industries and those established within the free zone, on the other.

Apart from the above, a major advantage which free zones could bring to the developing country lies in the fact that the host country will be in the position to concentrate all its efforts to fulfil the prerequisites of an export oriented industrial production on an international level within the limited area of the free zone. The provision of land and physical facilities including infra-structure is as important a factor as the various financial and economical incentives for pushing forth the industrialization programme of the developing countries. Should the objective area be limited to such as a free zone, the host country will have an easier task of achieving this condition, and thus create the necessary circumstances and atmosphere for attracting new investments from domestic and foreign sources for stimulating and accelerating the establishment of export oriented industries.

To date, more than 100 free ports and free zones are established throughout the world. These free ports and free zones are established with objectives varying from one to another depending upon the situation and circumstances of the host country, and it is believed that they may be classified under one of the following types:

- a) For simple warehousing and transshipping purposes only.
- b) For warehousing and transshipping purposes as well as small-scale manipulation of the goods such as re-packing, labelling, etc.
- c) Same as above, but with a step further in the manipulation of the goods including also assembling, processing, manufacturing, etc.
- d) For industrial production on a larger scale, but including the types of work as per c).
- e) For specific industrial production only, such as petrol refining, petro-chemical production, shipbuilding, etc.
- f) For export oriented production only, usually based upon raw materials and semi-manufactures to be imported into the zone chiefly from abroad. The main portion of the finished products is, in principle, expected to be exported abroad, and only in exceptional cases imported into the host country's market.

UNIDO Assistance

Recently, the concept of establishing a free port or a free zone for promoting the export oriented industries has become very popular. A number of countries has already drawn up plans for the establishment of such free zones whereas many others are considering to do so. There are also countries which have already implemented their plans but due to some unforeseen obstacles and difficulties, the free port or free zone is not operating satisfactorily according to the anticipated function of accelerating the creation of industries oriented towards export production.

In view of the above situation, UNIDO is prepared to offer technical assistance services to those countries who plan to establish a free zone with incentives to promote export oriented industries, or to those who have implemented their plans but with so far rather unsuccessful results, in the following fields:

1) Make feasibility studies for establishing free zones in connexion with the promotion of industries oriented towards export production, also from the overall economic and industrial development point of view.

2) Give advice on the selection of industries suitable for being established in the free zone, taking into consideration the national development plans, the availability of domestic raw material resources, export market availability, etc.

3) Make recommendations concerning promotional incentives and privileges for stimulating the establishment of export oriented industries.

4) Make suggestions on the organizational machinery set up of the free zone, in order to ensure a smooth operation of the free zone along the lines of stimulating the export production industries.

5) Give advice on means and measures to attract suitable and proper entrepreneurship especially from foreign countries.

6) Make other suggestions and recommendations connected directly and indirectly with the establishment, management and operation of a free zone as incentives for the promotion of export oriented industries.

7) In case of assistance, in the sense of "trouble-shooting", to the already existing free ports or free zones, which are operating inefficiently, UNIDO can:

- a) evaluate its current performance
- b) suggest changes in policies
- c) suggest changes in the organizational set up
- d) suggest improvements in operational procedures
- e) advise on any other measures

for accelerating the promotional activities on the establishment of export oriented industries within the free port/free zone area.

Combined with these assistance possibilities on free zones as incentives for the promotion of export oriented industries, UNIDO, in co-operation with UNCTAD-GATT/ITC, could render assistance on market surveys and marketing of selected articles having positive export potential and thus support the justification of the export oriented industries established within the free zone territory.

At present, UNIDO is preparing a study on free zones as incentives for the promotion of export oriented industries by collecting, analysing and evaluating various studies, information, reports and statistics on different free zones. It is expected that the study shall be available for distribution in the near future.

Any developing country can avail itself of such UNIDO assistance by presenting an official request through the Resident Representative of the United Nations Development Programme in their country. Further information on the subject can be obtained from:

Export Industries Section
Industrial Policies and Programming Division
U N I D O
P. O. Box 707
Rathausplatz 2
A-1010 Vienna
Austria.